

Challenger Capital Notes Newsletter February 2017



Peter Polson
Chairman

GROUP ASSETS UNDER MANAGEMENT UP 12%

\$ **65** bn

NORMALISED PROFIT AFTER TAX

↑ **8%**

REGULATORY CAPITAL ABOVE APRA'S MINIMUM REQUIREMENT

\$ **0.8** bn

Dear Noteholder

On behalf of the Board and management team, I'm pleased to provide you with an update on the performance of Challenger Limited.

Growth in earnings

All key underlying performance measures increased in the first half of 2017. We have also paved the way for further success through expanding our annuity distribution relationships and our product range.

However it's not just the 1H17 numbers that are comforting, it's also the progress made in the last six months that positions the business up for further success.

Total assets under management are now \$65 billion, which makes us Australia's seventh largest asset manager.

Assets under management continue to benefit from strong Funds Management net flows, which were \$3.2 billion for the half and strong growth in Life's annuity book. Life's annuity book increased by \$843 million for the half, benefiting from the new distribution initiatives put in place over the last eighteen months.

This growth in assets under management drove an 8% increase in normalised net profit after tax to \$197 million for the six months ended 31 December 2016. Normalised earnings per share increased by 7% to 35.0 cents per share.

Statutory net profit after tax¹ was \$202 million, and includes the impact of valuation changes on Challenger Life's assets and liabilities. However statutory profit after tax was lower than the first half of 2016, due to a \$22 million one-off gain included in 2016 following the sale of one of our boutique investment managers.

We continue to maintain a strong capital position and were holding at 31 December 2016 some 40% or \$0.8 billion more capital than the Australian Prudential Regulation Authority's minimum requirement.

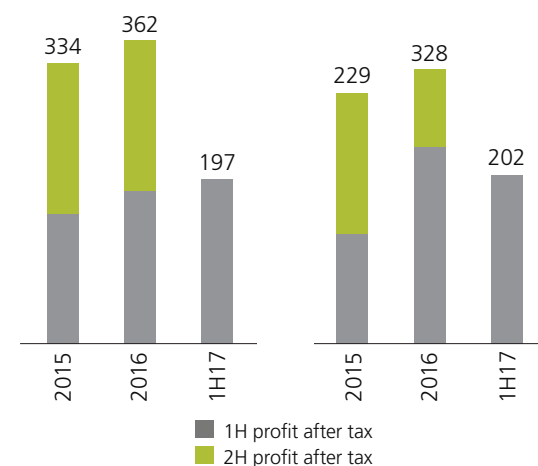
We are growing strongly and we have plans to further strengthen our capital position through the launch of Challenger Capital Notes 2 (details included on the following page).

Normalised profit after tax (\$m)

up 8%

Statutory profit after tax (\$m)

down 14%



Life business update

1H17 Life earnings were \$267 million and increased by \$18 million (7%) on the previous year (1H16).

The Life business targets Australia's increasing superannuation savings pool and the rapidly rising number of retirees, with products helping convert savings to regular and reliable income streams.

Over the past five years annuity sales have increased by an average of 17% each year. For the first half of 2017 they grew even more strongly, up 34%. Life annuity sales continue to benefit from our expanded product and distribution footprint.

1. Normalised profit framework and a reconciliation to statutory net profit after tax is disclosed in the Directors' Report of the Challenger Limited Interim Financial Report 2017.

In the last six months our annuities have been made available on the ClearView's platform, and by three profit-for-member funds (caresuper, legalsuper and Local Government Super). Suncorp also commenced selling Challenger annuities under its own brand. These initiatives are helping expand our annuity sales and Challenger's growth profile.

We have also recently announced that from the end of the September 2017 quarter, it is expected that both AMP and BT Financial Group will add Challenger annuities to their platforms. This will allow Challenger annuities to be easily and efficiently combined with other products to provide secure and dependable incomes for their customers.

In addition, in November 2016 we commenced a new annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of Australian dollar annuity and life insurance products in Japan. Annuity sales via the MS Primary relationship are long term in nature. We are off to a strong start with \$125m of sales for the first two months.

The growth of Australia's retirement income market is now supported by the regulatory agenda. Over the past six months we have seen substantial progress in the creation of a policy framework for a world class retirement income system, one that shifts the focus from wealth accumulation to providing stable income in retirement.

Federal Government policy reform underway includes defining the objective of superannuation, legislating new rules that will allow a new range of retirement products to provide retirees with more choice and issuing a discussion paper for Comprehensive Income Products for Retirement (CIPRs), which the Government proposes calling MyRetirement.

These regulatory reforms will enhance the retirement phase of superannuation in the future. We are already seeing some superannuation industry participants move ahead and implement retirement solutions that combine longevity solutions, like annuities, with other products to provide better outcomes for retirees.

Funds Management update

The Funds Management business generally targets the retirement savings phase of superannuation by providing investment products aiming to deliver superior investment returns in order to maximise superannuation savings.

Funds Management attracted very strong flows, with \$3.2 billion for the half.

Despite the strong increase in funds under management and a rebound in UK transaction activity following the Brexit vote, Funds Management earnings fell by \$1 million due to lower performance fees.

We are focused on growing our stable of boutiques, and recently announced a new boutique fund manager, Avenir Capital, a global equities manager. This new boutique, together with ~\$110 billion of available capacity across our managers should ensure we continue to benefit from growth in Australia's super system.

Launch of Challenger Capital Notes 2

Challenger's Life business continues to grow strongly. In order to prepare for future growth, Challenger intends launching Challenger Capital Notes 2 in the first quarter of the 2017 calendar year, subject to market conditions.

Challenger Capital Notes 2 are similar to Challenger Capital Notes in that they are subordinated and convertible securities. Challenger is targeting to raise \$350 million through the new note issue, subject to market conditions.

As a Challenger Capital Notes noteholder, you will receive separate communications from Challenger in respect of the launch of these Notes, including how to participate.

A prospectus for the Challenger Capital Notes 2 will be made available at the time of the offer. You will need to complete an application form that accompanies the prospectus in order to participate.

I would like to thank you for your ongoing support and commitment to Challenger.



Peter Polson
Chairman
Challenger Limited

Manage your holding

For administrative matters in respect of your Challenger Capital Notes holding, please contact Computershare Investor Services.

T: 1800 780 782

 computershare.com/investor

Go electronic

Challenger can deliver your noteholder communications electronically. Please update your communication preferences via Computershare Investor Services.

Challenger Capital Notes distribution history

| Distribution Payment Date | Distribution ¹ | Total return ² |
|---------------------------|---------------------------|---------------------------|
| 25 May 2016 | A\$0.98 | 5.6883% |
| 25 August 2016 | A\$0.95 | 5.3950% |
| 25 November 2016 | A\$0.90 | 5.1250% |
| 27 February 2017 | A\$0.93 | 5.1550% |

Distributions 2017

| Ex-date | Record date | Payment date |
|------------------|------------------|------------------|
| 16 February 2017 | 17 February 2017 | 27 February 2017 |
| 16 May 2017 | 17 May 2017 | 25 May 2017 |
| 16 August 2017 | 17 August 2017 | 25 August 2017 |
| 16 November 2017 | 17 November 2017 | 27 November 2017 |

1. The Distribution is the cash payment made on each \$100 Challenger Capital Note for the relevant quarterly Distribution Period. It is calculated as the Distribution Rate, multiplied by the number of days in the relevant quarterly Distribution Period, applied to each \$100 Challenger Capital Note.

2. The total return (expressed as a percentage per annum) for each quarterly Distribution Period is equal to the aggregate of the Bank Bill Rate and the Margin of 3.40%. The total return for the relevant quarterly Distribution Period represents (as a percentage per annum) the aggregate of the cash payment and the Franking credits.