Market Release

CHALLENGER LIMITED FY12 RESULTS

Record total Life product sales of $2.66 billion, up 35%
Record retail annuity product sales of $1.95 billion, up 34%
Net retail book growth of 10%, or $583 million
Normalised NPAT of $297 million, up 20%
Statutory NPAT of $149 million due to volatile markets (FY11 $261 million)
Normalised EPS of 57.5 cents per share, up 11%
Final dividend of 10.5 cents; full year dividend of 18.0 cents, up 9%

20 August 2012, Sydney – Challenger Limited (ASX: CGF) today announced another year of strong sales and normalised profit growth in difficult investment markets, with normalised net profit after tax* (NPAT) reaching $297 million for the year ended 30 June 2012, a 20% increase on the prior corresponding period (pcp). Statutory NPAT was $149 million.

Normalised earnings per share (EPS) increased by 11% to 57.5 cents but rose proportionately less than normalised NPAT due to an increase in shares on issue, with the number of shares issued pursuant to the exercise of CPH options being greater than those repurchased under Challenger's buyback.

Chief Executive Officer Brian Benari said: "We're very happy with top and bottom line performance and continue to reap the benefit of the organic sales engine we created in both our annuities business and our Fidante Partners boutique funds management operation.

"While conditions for all wealth managers have been trying over the last four years, during this period Challenger has grown normalised profit by 36% from $218 million to $297 million, and normalised earnings per share by 55% from 37.1 cents to 57.5 cents.

"And like everyone else in the sector, we've been mindful to watch our cost base - but are fortunate that our assets under management, sales and profits have been growing. Our operating leverage is excellent", said Mr Benari.

Challenger Life's record total product sales of $2.66 billion were comprised of a very large increase in institutional sales to $704 million, together with record retail sales of annuity products of $1.95 billion. Retail sales grew by 34% over the prior year, outstripping both the original and upgraded targets of 25% and 30%, respectively.

Challenger Funds Management's funds under management (FUM) rose to $31 billion, up 31% or $7.4 billion, with net flows of $4.2 billion including $1.1 billion from the acquisition of Asian emerging markets specialist MIR Investment Management by Fidante Partners, Challenger's boutique funds management umbrella brand.

In 2012, nine of Fidante's eleven boutique fund managers recorded positive net flows for the year. According to Rainmaker's most recent data, Challenger is now a top 10 Australian fund manager.

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During the year, Challenger's cost-to-income ratio was driven to a record low of 35.9%, with the company's cost base of $189 million equivalent to 2008 levels.

"Our business is highly scalable, and due to our strong growth outlook, we have lowered our target cost-to-income ratio range to 34% to 38% from 35% to 40%", he said.

Statutory NPAT for the year of $149 million was lower than normalised profit and in contrast to the 2011 and 2010 years in which Challenger's statutory profit exceeded its normalised profit.

Ongoing volatility has affected Challenger's statutory profitability because life insurance accounting standards require that statutory NPAT include realised and unrealised movements in the value of assets and liabilities. This includes changes in the trading prices of fixed income assets which are being held to maturity by Challenger, like Australian government and investment-grade corporate bonds.

"In volatile periods like we've experienced over the last five years, statutory profit may be significantly more than or less than normalised profit", said Mr Benari.

During the year Challenger's assets under management rose 20% to $33.4 billion.

Life's assets under management increased by 17% to $9.8 billion while its normalised cash earnings were $436 million, an increase of 9% over the pcp. Life's excess capital above regulatory requirements plus group cash stood at $813 million at 30 June 2012, comprising excess Life capital of $719 million plus Group cash of $94 million.

The Group generated an increased underlying operating cashflow of $282 million and has nil recourse debt.

The declared final dividend is 10.5 cents unfranked, bringing the full year dividend to 18.0 cents unfranked, an increase of 9% on the pcp.

New capital standards

As recently advised to the market, the Australian Prudential Regulation Authority (APRA) will be introducing new capital standards for all life and general insurers which are designed to ensure they have sufficient capital to absorb 1:200 year adverse shocks.

APRA has proposed to Challenger Life a three year transitional period in relation to these requirements and will permit its subordinated debt to continue as regulatory capital until each tranche's first call date after 1 January 2013, after which each tranche's eligibility will be phased out over a minimum five year period. The largest tranche of sub-debt commences amortisation in 2017.

Challenger will also have three years to transition to the minimum requirement that Tier 1 capital represents 80% of regulatory capital.

Final arrangements are subject to continued discussions and confirmation from APRA which is expected to be received in the fourth quarter of calendar 2012.

Outlook

Mr Benari said he expects both of Challenger's business divisions to keep growing in 2013.

"We're uniquely placed to benefit from the structural changes occurring in the retirement savings market, while at the same time retaining a large exposure to any sustained recovery in equity and credit markets.

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“Investors will always want exposure to growth assets, but as we’ve witnessed first-hand in our recent advertising focus groups, people around retirement age are focussed very heavily on capital protection. We are serving both market needs with a dual-brand strategy whereby Challenger stands for security and reliability and Fidante Partners stands for consistent alpha-generation throughout the cycle.

“The outlook continues to be positive. For 2013 we’re targeting 15% retail annuity sales growth, 10% net retail book growth of $675 million and $440 to $450 million in cash earnings for the life company”, said Mr Benari.

*The Normalised Profit figures are non-statutory amounts and in Challenger's view better reflect the underlying operating performance of the business. The Normalised Profit figures exclude investment experience, being the difference between actual investment gains and losses (both realised and unrealised) and the normalised gains and losses (being based on Challenger's long term assumed returns). The Normalised Profit framework and a reconciliation to statutory profit have been disclosed on page 18 in the Director's Report and Note 2 - segment information, in the Challenger Limited 30 June 2012 financial report. The Normalised Profit is not audited but has been subject to a review performed by Ernst & Young.

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