challenger

# MARKET RELEASE

## CHALLENGER LIMITED FY13 RESULTS

**Annuity sales of $3.1 billion, with $10.8 billion now under management.**
Lifetime annuity sales of $257 million, more than total industry sales in any year since 2004.

**Funds management division achieved net flows of $7.0 billion, with $41.1 billion in FUM**
Revitalised business is now Australia's ninth largest fund manager, up from 19th only two years ago.

19 August 2013, Sydney – Challenger Limited (ASX: CGF) today announced record flows into its annuities and funds management businesses, with total assets under management rising by 34% to $44.8 billion at 30 June 2013. This resulted in normalised EBIT of $365 million, up 8%, and normalised NPAT* of $309 million, an increase of 4%. Statutory NPAT rose to $417 million from $149 million, an increase of 180%.

Chief Executive Officer Brian Benari said: "This has been a pivotal year for Challenger in many ways. Our funds management business is growing strongly and profitably from the solid foundations laid over the last few years, while our annuities business continues to prosper as Baby Boomers retire and seek security and regular income.

"Despite having to re-base our business around tougher regulatory capital rules, our post-tax normalised return on equity remains strong at 16.8%. In fact, we did this while ending the financial year with $1.1 billion of excess regulatory capital and group cash.

"We're pleased to announce our intention to partially frank the final 2014 dividend, and to increase our dividend payout ratio to 35%-40%.

"Our funds management "super savings" business is directly leveraged to the markets, with strong boutique performance leading to high flows and earnings growth. In our annuities "super spending" business, an ageing population, market uncertainty and product innovation are countering any effect of a lower interest rate environment".

Challenger Limited's normalised EPS increased by 2% to 58.6 cents per share (cps). The full year dividend rose 11% to 20.0 cents per share (cps) following the Board's declaration of a final dividend of 10.5 cps. While Challenger's dividends remain unfranked in 2013, the company expects to partially frank its final dividend in 2014 and to lift its dividend payout ratio by five percentage points to 35%-40% of normalised profit.

Discipline around costs is an abiding focus for the company, with its cost base rising by only 2% against total AUM growth of 34%. This led to a further reduction in Challenger's cost to income ratio to 34.4%, and another downward revision in its targeted ratio, this time by two percentage points to 32%-36%.

### Capital

Challenger bought back 14 million shares during the year and is continuing its buy back program into 2014.

As flagged to the market in November 2012, APRA's new regulatory capital rules increased Challenger Life's capital requirement by $323 million, with APRA providing transitional relief for three years. As at 30 June 2013, Challenger held $1.1 billion more capital and cash than APRA's current required minimum, and Challenger Life's Prescribed Capital Amount (PCA) ratio was 1.8 times, higher than its 1.4-1.6 times targeted range. Excluding the LAGIC transition balance, Challenger Life has a PCA ratio of 1.4 times, so is already falling within this range.

Further enquiry: Investors - Stuart Kingham, Challenger Limited, 02 9994 7125
Media - Stuart Barton, Challenger Limited, 02 9994 7008
Media - Nicole Webb, Challenger Limited. 02 9994 7806

**Life (annuities)**

Total annuity product sales reached $3.1 billion, up 18% on last year, and comprising retail sales of $2.2 billion, up 12%, and institutional sales of $952 million.

Of the $2.2 billion in retail sales, $1.9 billion were fixed term annuities, with lifetime annuities comprising the balance of $257 million, up from $46 million in 2012, and more than the entire industry has sold in any year since 2004.

Challenger's retail annuity book grew by 9%, or $598 million. Growth of 8% has been targeted for 2014, excluding expected maturities relating to the Challenger High Yield Fund annuities.

Challenger Life had $10.8 billion under management as at 30 June 2013, 10% more than twelve months' prior. Against this, an average margin of 4.5% delivered Life cash operating earnings (COE) of $452 million, an increase of 4%. The average margin for 2014 is expected to be sustained at 4.5%.

A trend to longer tenor annuity sales is benefitting Life's earnings, with the average term of new annuity business rising to 6.2 years from 5.4 years in 2012.

**Funds management – Fidante Partners and Aligned Investments**

"While Challenger Life's annuities business remains the largest contributor to our performance, funds management has now reached critical mass and is delivering strong earnings growth and an ROE of 26%", said Mr Benari.

Challenger's funds management business had a very strong year, with net flows increasing by 65% to $7.0 billion driving total funds under management up 33% to $41.1 billion, with EBIT growing 62% to $34 million.

"We now have the ninth largest fund manager in Australia^ and the fastest growing part of Challenger in both a FUM and earnings sense. It's leveraged to markets and the mandated growth of our superannuation system. We added two new boutiques to Fidante Partners post-30 June and are looking to back additional teams this year, said Mr Benari.

"Around $11 billion of this FUM is managed within the newer Aligned Investments division, in which Challenger Life "clubs" with super funds and other institutions looking for high relative value investments in fixed income, property and infrastructure.

"This "clubbing" ability allows Life to participate in larger transactions like five shopping centres from Federation Centres and gives it a stronger negotiating position regarding pricing, terms and covenants", said Mr Benari.

The Fidante Partners business accounted for approximately $30 billion of Funds Management's FUM, spread across individually branded fund managers.

**Distribution, Product and Marketing**

Retail investor demand for annuities is helping drive institutional relationships for Challenger, with arrangements struck this year with Bendigo and Adelaide Bank and industry fund QSuper.

"Funds seeking to maximise choice for their retiring members are taking notice of the demand for guaranteed income products", said Mr Benari.

The provision of superior support and service for financial advisers remained a key priority during the year, with Challenger annuities ranking first for BDM support and second for technical services in a Wealth Insights benchmark survey against eighteen leading fund managers.

Product innovation lies at the heart of Challenger's revival of the Australian lifetime annuities market. 2013 was focused on establishing a distribution beachhead for the Liquid Lifetime and Care Annuities, and calendar 2014 will see the debut of Deferred Lifetime Annuities (DLAs), legislation permitting.

"Deferred annuities have a simple but powerful promise which should appeal to many retirees - don't worry about spending more in your active, early years of retirement, because you're protected by guaranteed annuity income arriving in the later years", said Mr Benari.

The establishment of Challenger as a leading brand in retirement incomes is of continued importance, with a 2013 brand benchmarking survey indicating that the company has retained its market-leading status in this regard among financial advisers.

"Advertising is a big part of building the Challenger brand among consumers and in September we'll kick-off a new campaign showing that annuities are more than just a safe haven from volatile markets. They're like a reliable retirement paycheque, protecting you from financial forces you can't control, and paying guaranteed income for life, if you choose".

**Outlook**

Mr Benari remains confident about the year ahead, and said: "it's early days yet, but we like what we're seeing so far, so have set a target for Life's cash operating earnings of between $465 million and $475 million.

"Fidante Partners kicked off 2014 with 22% more FUM than 2013's average, so if investment performance remains strong we'll benefit greatly from the leverage this business now produces".

| Overview | FY13 | FY12 | Movement |
|---|---|---|---|
| Normalised NPAT ($m) | 308.5 | 296.8 | 4% |
| Statutory NPAT ($m) | 416.8 | 148.5 | 180% |
| Normalised EBIT ($m) | 364.8 | 338.3 | 8% |
| Normalised EPS - basic | 58.6 | 57.5 | 2% |
| Statutory EPS - basic | 79.2 | 28.8 | 175% |
| Normalised ROE<br>- post tax% | 16.8 | 18.8 | (200) bps |
| Statutory ROE<br>- post tax% | 22.7 | 9.4 | 1330 bps |
| Dividend (cps) | 20.0 | 18.0 | 11% |

* As required by Life insurance accounting standards, statutory NPAT includes realised and unrealised movements in the value of assets and liabilities. 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 20 in the Director's Report and Note 2 - segment information, in the Challenger Limited 30 June 2013 financial report. The Normalised Profit is not audited but has been subject to a review performed by Ernst & Young.

^ Consolidated FUM for Australian fund managers - Rainmaker Roundup March 2013.

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