Market release

Challenger Limited

12 February 2019

# CHALLENGER ANNOUNCES HALF YEAR RESULTS

- Total assets under management $78.4 billion, up 2%
- Normalised net profit before tax[1] $270 million, down 2%
- Normalised net profit after tax[1] $200 million, down 4%
- Statutory net profit after tax $6 million, down 97%
- Interim dividend 17.5 cents per share, unchanged
- $1.4 billion excess regulatory capital and cash

**Challenger Limited (ASX:CGF)** today announced its results for the half year ending 31 December 2018, with performance impacted by challenging operating conditions. Total assets under management were $78.4 billion, up 2% on the prior corresponding period (pcp). Normalised net profit before tax was $270 million, 2% lower than the pcp, and statutory net profit after tax was $6 million.

Challenger Chief Executive Officer Richard Howes said while the results reflect the challenging operating environment, he is confident the business is well placed to respond to the current market and capture opportunities for future growth.

"Our results for the first half have clearly been impacted by the difficult operating environment we're experiencing, with increased market volatility, industry disruption and political uncertainty playing out across the sector. While some of these factors are beyond our control, the fundamentals underpinning our business remain supportive. We continue to target a growing market of retirees, we have the leading retirement income brand in the country and our capital position remains very strong.

"Our resilient position is well demonstrated by the solid domestic annuity sales we achieved in the half. Australian annuity sales were up 4% on the same period last year, reflecting the continued demand from retirees for our products.

"In our Funds Management business, growth in net income driven by higher average funds under management was partially offset by lower performance fees, which is consistent with what we have seen across the industry.

"We retain a strong capital position with $1.4 billion of excess regulatory capital and group cash, and Challenger Life has a PCA[2] ratio of 1.54 times, which is toward the upper end of our target range. This demonstrates the strength and resilience of our business in these market conditions.

"Challenger is well placed to manage through the cycle and capture the opportunities for growth we see ahead."

## Group financial performance

Assets under management were $78.4 billion, up 2% on the pcp. Normalised net profit before tax was $270 million, down $5 million or 2% on the pcp. Earnings were impacted by investment market volatility resulting in lower asset returns in the Life business, particularly absolute return fund distributions ($13 million lower than the pcp), and lower Funds Management performance fees ($4 million lower than the pcp).

Normalised net profit after tax was down $8 million or 4% to $200 million reflecting a normalised tax rate of 26%.

Statutory net profit after tax includes investment experience (being valuation movements on assets and liabilities supporting the Life business) of -$194 million (after tax). This was mainly due to lower equity markets and wider fixed income credit spreads. Statutory net profit after tax was $6 million.

Normalised return on equity (ROE) was lower at 15.6% (pre-tax), impacted by lower normalised net profit before tax and higher capital levels held.

Challenger declared a fully franked interim dividend of 17.5 cents per share. This is unchanged on 1H18, and is supported by Challenger's strong capital position.

## Capital

Challenger continues to be strongly capitalised with $1.4 billion in excess regulatory capital and cash above APRA's minimum requirement. This reflects a ratio of 1.54 times the PCA and is toward the upper end of Challenger's target PCA range of 1.3 to 1.6 times.

Challenger's capital position benefited from lower capital intensity within Life's investment portfolio, which reduced from 14.1% to 13.0% during the half. This reflects recent Life portfolio changes including increasing fixed income credit quality and implementing an equities collar strategy.

Capital intensity is expected to fall further following a reduction in Life's property allocation, as previously flagged by Challenger.

In December 2018, Standard & Poor's (S&P) reaffirmed the credit rating and outlook for Challenger Life Company Limited as 'A' with a positive outlook; and Challenger Limited as 'BBB+' with a positive outlook.

## Challenger Life

Life cash operating earnings (COE) was $330 million, down 2% on the pcp, with higher investment assets offset by a lower COE margin. The COE margin reflects the impact of lower absolute return fund distributions received in the half.

Challenger continued to grow its Life book to a record $14.5 billion with Life book growth of 4.2% in the half, driven by solid domestic sales and a lower maturity rate. An increased focus on longer term business over recent years has resulted in long-term annuities now accounting for 38% of the total book (or 45% of the annuity book), up from 18% five years ago.

Total Life sales were $2.7 billion, down on the pcp, due to a lower contribution from Japan (-$0.2 billion) and the timing of institutional maturities and subsequent reinvestments (-$0.4 billion).

Total annuity sales were $2.1 billion, down 7% on the pcp due to the decline in Japan sales, which were down 55% with higher US interest rates relative to Australia reducing demand for Australian dollar products in Japan.

Domestic annuity sales grew 4% with Lifetime sales up 5% driven by continued strong growth in CarePlus, which was up 14%.

Australian fixed term sales were up 3% on the pcp to $1.5 billion. This result was skewed to the first quarter with second quarter sales lower, reflecting disruption across the wealth and financial advice industry.

Sales of other Life products were $0.6 billion, down 42%, due to there being fewer mandate maturities in the period, resulting in lower subsequent rollovers.

## Funds Management

Funds Management average funds under management increased 9% to $77.4 billion with Fidante Partners up 8% and Challenger Investment Partners up 11%.

Net flows were -$1.0 billion impacted by a large Australian institutional fixed income mandate redemption.

Funds Management was also impacted by market conditions resulting in lower performance fees in the period. Net income was up $3 million or 4% to $75 million with performance fees of $2 million, down $4 million on the pcp. Earnings before interest and tax was $26 million, down $1 million on the pcp.

Long-term growth in Funds Management is underpinned by strong fund performance with 92% of funds under management outperforming benchmarks over five years.

## Strategic progress

Challenger continues to make progress implementing its strategy to take advantage of the broad demographic tailwinds behind Australia's growing retirement income market.

Challenger's product offering is appealing for retirees in this environment as they seek guaranteed income and longevity protection amid sustained market volatility and political uncertainty.

We continue to expand our distribution reach with the launch on the BT Panorama platform in the first half followed by new relationships formed with fast growing independent platforms. Challenger annuities are on track to launch on Hub24 and Netwealth platforms in the second half of this financial year.

Challenger continues to be recognised as a clear leader in retirement income over many years, maintaining a strong brand and reputation. Amongst advisers, Challenger retained and strengthened its leadership position, ranked first place at 95%[3], despite challenges across the sector.

Trust in the quality of our products and services, and our ongoing focus on improving the experience for our customers and advisers has contributed to our strong brand and reputation. In December, Challenger launched a new website with dedicated content specifically designed for customers and advisers and an improved lead nurturing capability. The new site supports our efforts to better educate customers about retirement income options and assists advisers with their conversations with clients. Later this year, we will launch a new brand campaign focused on educating customers and advisers on the role annuities can play in retirement.

While the retirement income reform process has been impacted by political uncertainty and the election cycle, there has been bipartisan support over many years for policy development to strengthen the retirement phase of superannuation. Challenger is engaging broadly and leveraging our research to contribute to the public policy debate.

Challenger also continues to grow its Funds Management business through new product and distribution initiatives. Progress has already been made in the second half with FME Asset Management joining Fidante's London-based boutiques. In December 2018, Fidante Partners launched ActiveX, a series of active ETFs, to address the growing market for exchange traded products. The first in the series is an active fixed income ETF from Ardea Investment Management. Fidante expects to launch more active ETFs from its other boutiques from the second half of the financial year.

## Outlook

Reflecting the current operating conditions, Challenger expects FY19 normalised net profit before tax to be between $545 million and $565 million. This reflects a number of factors including lower than expected 1H19 earnings and flow on effects in 2H19, and impact from a reduction in capital intensity across Life's investment portfolio.

As previously indicated, Challenger is not expected to reach its 18% normalised return on equity before tax target in FY19 due to lower earnings.

Challenger continues to target a dividend payout ratio of 45% to 50% of normalised net profit after tax.

### Investor presentation webcast

*Challenger Managing Director and Chief Executive Officer, Richard Howes, and Chief Financial Officer Andrew Tobin will give an investor presentation on the results at 10.30am (EST) on 12 February 2019. The presentation will be streamed live via webcast which can be accessed at [www.challenger.com.au](http://www.challenger.com.au)*

## Key metrics

| | 1H19 | 1H18 | Change |
|---|---|---|---|
| Total assets under management ($bn) | 78.4 | 76.5 | 2% |
| Average assets under management ($bn) | 80.3 | 74.0 | 8% |
| Life book growth ($bn) | 0.6 | 0.9 | (38%) |
| Total Life sales ($bn) | 2.7 | 3.3 | (18%) |
| Annuity sales ($bn) | 2.1 | 2.3 | (7%) |
| Funds Management net flows ($bn) | (1.0) | 3.9 | (125%) |
| Normalised NPBT ($m) | 270 | 275 | (2%) |
| Normalised NPAT ($m) | 200 | 208 | (4%) |
| Statutory NPAT ($m) | 6 | 195 | (97%) |
| Normalised basic EPS (cps) | 33.1 | 35.2 | (6%) |
| Statutory basic EPS (cps) | 1.0 | 33.1 | (97%) |
| Normalised ROE pre-tax (%) | 15.6 | 16.8 | (120 bps) |
| Statutory ROE post-tax (%) | 0.3 | 11.9 | large |
| Normalised cost to income ratio (%) | 32.7 | 32.1 | 60 bps |
| Interim dividend (cps) | 17.5 | 17.5 | unchanged |

ENDS

**About Challenger**

Challenger Limited (Challenger) is an investment management firm focused on providing customers with financial security for retirement.

Challenger operates two core investment businesses, a fiduciary Funds Management division and an APRA-regulated Life division. Challenger Life Company Limited (Challenger Life) is Australia's largest provider of annuities.

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[1] 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 and significant items. Investment experience is 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), as well as any impact of changes in economic variables and assumptions used to value liabilities. The normalised profit also excludes any significant items which represent one-off or abnormal gains or losses for the period. The normalised profit framework and reconciliation to statutory profit is disclosed in the 2019 Interim Financial Report - Operating and Financial Review section. The normalised profit is not audited but is subject to a review performed by Ernst & Young.

[2] The Prescribed Capital Amount (PCA) ratio is the ratio of Challenger Life Company Limited’s regulatory capital base divided by the PCA.

[3] Marketing Pulse Adviser Study December 2018