CHALLENGER ANNOUNCES HALF YEAR RESULTS[1]

- Group assets under management $86 billion, up 10%
- Normalised net profit before tax* $279 million, up 3%
- Normalised net profit after tax* $191 million, down 4%
- Statutory net profit after tax* $220 million, up $214 million
- Normalised return on equity 15.2%, 30 bps above target
- Interim dividend 17.5 cents per share, unchanged
- Excess regulatory capital and Group cash $1.5 billion, up $0.1 billion

Challenger Limited (ASX:CGF) has today announced its results for the half year ending 31 December 2019, with strong growth in assets under management driving earnings growth.

Managing Director and Chief Executive Officer, Richard Howes said Challenger is on track to achieve 2020 full year normalised net profit before tax around the top end of its guidance range of $500 million to $550 million.

“The ongoing execution of our carefully planned strategy, together with our response to industry disruption has put Challenger in a good position to optimise performance in the current environment,” Mr Howes said.

“Challenger continues to prove to be resilient. Our business model, leading brand and diversified distribution have ensured we can continue to deliver solid earnings despite significant and ongoing challenges in our operating environment.

“In our Life business, strong Japanese and Australian institutional sales have offset lower domestic sales, which continue to be impacted by disruption in the financial advice market. In Funds Management, exceptional retail flows together with institutional inflows boosted earnings momentum, with net flows of $1.9 billion for the half.”

Challenger has also made significant progress against its strategic priorities during the half. This has included the commencement of a new arrangement with MS Primary to reinsure US dollar annuities in Japan, addition of new partners in the Funds Management business and investment in a range of distribution, product and marketing initiatives in response to changes in the domestic wealth management market.

“We see a significant opportunity in engaging more directly with prospective customers and increase support for advisers to better meet customer needs.

“Our investment of up to $15 million this year in a range of distribution, product and marketing initiatives will position Challenger to capture growth as the retirement incomes market evolves.”

[1] All percentage and dollar movements compare 1H20 to the prior corresponding period (1H19) unless otherwise stated.

Group financial performance

Group assets under management were $86 billion, up 10% on the prior corresponding period (pcp). Normalised net profit before tax was up $9 million to $279 million or up 3% on the pcp, including the impact of the investment in future growth initiatives. Normalised net profit after tax was down $8 million (4%) on the pcp to $191 million due to a higher effective tax rate.

Statutory net profit after tax was up $214 million to $220 million. This includes positive investment experience of $38 million, which is the valuation movements on assets and liabilities supporting the Life business. It also includes a significant item loss of $9 million which relates to the impairment and associated windup costs of two Funds Management boutiques.

Normalised pre-tax return on equity was 15.2%. This was 30 basis points above the target of the RBA cash rate plus a margin of 14% announced in June 2019.

Reflecting Challenger's strong capital position and confidence in future growth, Challenger has declared a fully franked interim dividend of 17.5 cents per share, which remains unchanged on last year.

Capital

Challenger has maintained a strong capital position with $1.5 billion in Challenger Life Company Limited (CLC) excess regulatory capital above APRA's minimum requirement and Group cash. This reflects a ratio of 1.54 times[2] the Prescribed Capital Amount and is toward the top end of the target range of 1.3 to 1.6 times.

Challenger Life

Total Life sales were up 15% to $3.1 billion, reflecting a strong contribution from Challenger's Japanese partnership and Australian institutional sales. This was offset by lower domestic sales, which continue to be impacted by ongoing industry disruption.

Total annuity sales were down 9% ($0.2 billion) to $2.0 billion, and include domestic sales of $1.5 billion (down $0.5 billion) and Japanese sales by MS Primary of $0.5 billion (up $0.3 billion). Domestic term annuity sales benefited from a new institutional relationship and the growth in MS Primary sales were supported by Challenger commencing reinsurance of US dollar annuities during the half. Lifetime annuity sales were $0.2 billion (down $0.2 billion) and were impacted by changes to the age pension means test rules introduced on 1 July 2019.

Other Life sales were up 97% to $1.2 billion, reflecting strong demand from institutional clients for guaranteed returns in the low interest rate environment.

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

The strong Japanese and Australian institutional sales contributed to Life book growth of $0.9 billion, with the total Life book increasing by 6.2%[3] for the half. The annuity book continues to shift toward long-term annuities, being Australian lifetime and MS Primary. Long term annuities represented over one third of all annuity sales, which pushed the tenor of new business sales to over nine years. The long-term annuity book is now the same size as the fixed term annuity book, which will underpin future earnings.

Life cash operating earnings were up 5% to $345 million reflecting growth in investment assets.

Strong progress was made building on Life's wholesale longevity business with three transactions completed in the UK pension market during the half. These transactions resulted in a significant increase in the present value of expected future profits from Life Risk, which will also support future earnings growth.

Life's earnings before interest and tax of $286 million was up 3%. This included expenses of $6 million from the investment in distribution, product and marketing initiatives.

Challenger is responding to the ongoing disruption by investing in a range of growth initiatives to reshape the business for the evolving wealth management market. This includes a focus on supporting more direct engagement with prospective customers, increasing support for advisers to better meet changing customer needs and expanding our capabilities in partnering with institutional clients.

While disruption in the retail advice market is expected to be ongoing, Challenger's strong brand and reputation, and diversified distribution networks has supported the resilience seen in the business across the half.

Challenger continues to be recognised as the number one retirement income brand with a strong reputation among customers and advisers. The December 2019 Marketing Pulse survey found 93% of advisers rate Challenger as the leading retirement income brand.

Funds Management

Funds Management earnings were supported by strong growth in retail and institutional flows during the half, including $1.9 billion of net flows by Fidante Partners.

Earnings before interest and tax of $28 million was up 7%, driven by an increase in average funds under management (FUM), which was up 5% to $81.1 billion.

Fidante Partners continues to evolve its successful multi-boutique model, expanding partnerships and launching new high active boutique manager products. In October, Fidante announced a strategic joint venture with Ares Management Corporation, launching Ares Australia Management (AAM). AAM will bring high quality credit and other alternative investments from one of the largest global alternative asset managers to the Australian market.

[3] Total Life book growth percentage represents Life annuity net flows and Other Life net flows over the period divided by the opening Life annuity book, Guaranteed Index Return and Challenger Index Plus Fund liabilities.

Fidante Partners has also built on its ActiveX Series of active ETFs with the launch of the Kapstream Absolute Return Income Fund in the half. The launch follows the success of the ActiveX Ardea Real Outcome Bond Fund in 2018.

Long-term investment performance remains strong across Fidante Partners' stable of boutiques with 89% of funds achieving either first or second quartile investment performance[4].

In December, Challenger Investment Partners was appointed by the Australian Office of Financial Management (AOFM) as investment adviser to assist with the evaluation of investment proposals and management of the portfolio for the Australian Business Securitisation Fund, which has been established by the Australian Government to improve access to credit for small businesses.

Outlook

Challenger remains well positioned to optimise performance while also positioning for future growth. FY20 normalised net profit before tax is expected to be around the top end of Challenger's guidance range of $500 million to $550 million.

Challenger is also on track to achieve its normalised return on equity target of the RBA cash rate plus a margin of 14%.

The full year dividend is expected to remain unchanged from FY19 at 35.5 cents per share, which is above the target dividend payout ratio of 45% to 50% of normalised net profit after tax, reflecting Challenger's strong capital position and confidence in future growth.

Investor presentation webcast

Challenger's Managing Director and Chief Executive Officer, Richard Howes, and Chief Financial Officer, Andrew Tobin, will give a presentation to investors at 11am (Sydney time) on 11 February 2020. The presentation will be streamed live via webcast which can be accessed at www.challenger.com.au

Disclaimer

The forward-looking statements, estimates and projections contained in this release are not representations as to future performance and nothing in this release should be relied upon as guarantees or representations of future performance.

[4] Since boutique fund inception based on Mercer December 2019.

Key metrics

	1H20	1H19	Change
Total Group assets under management ($bn)	86.3	78.4	10%
Life net flows ($bn)	0.9	0.6	58%
Total Life sales ($bn)	3.1	2.7	15%
Annuity sales ($bn)	2.0	2.1	(9%)
Funds Management net flows ($bn)	1.9	(1.0)	n.a
Normalised NPBT* ($m)	279	270	3%
Normalised NPAT* ($m)	191	200	(4%)
Statutory NPAT* ($m)	220	6	large
Normalised basic EPS (cps)	31.5	33.1	(5%)
Statutory basic EPS (cps)	36.3	1.0	large
Normalised ROE pre-tax (%)	15.2	15.6	(40 bps)
Statutory ROE post-tax (%)	12.0	0.3	large
Normalised cost to income ratio (%)	33.5	32.7	80 bps
Interim dividend (cps)	17.5	17.5	unchanged

* 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 2020 Interim Financial Report - Operating and Financial Review section. The normalised profit is not audited but is subject to a review performed by Ernst & Young.

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About Challenger

Challenger Limited (Challenger) is an investment management firm focusing 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 is Australia's largest provider of annuities.

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