

# Challenger Capital Notes

Newsletter August 2018



Peter Polson  
Chair

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.

Challenger has maintained its business momentum and is well positioned for the next phase of growth. We are maximising the opportunities we see today by diversifying our products and distribution reach, while positioning for strong future growth opportunities, supported by increasing industry and Government focus on the retirement phase of superannuation.

## 2018 financial results

Challenger's performance in 2018 was underpinned by continued rapid growth in Assets Under Management (AUM) which increased 16% to more than \$81 billion. Over the last five years, AUM has increased by more than \$36 billion, reflecting significant growth in Life sales and very strong fund flows in the Funds Management business.

Normalised net profit after tax increased 6% to \$406 million while statutory net profit after tax, which includes valuing Life's assets and policy liabilities at fair value, was down 19% to \$323 million.

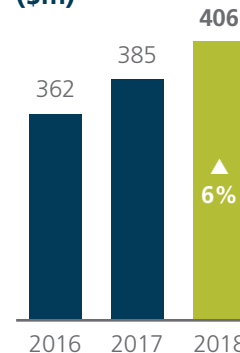
As forecast, normalised pre-tax return on equity (ROE) was lower at 16.5%, following the \$500 million strategic equity placement to MS&AD Insurance Group Holdings, the parent company of Challenger's Japanese annuity partner Mitsui Sumitomo Primary Life Insurance Company (MS Primary).

The full year dividend increased by 0.5 cents to 35.5 cents per share, fully franked.

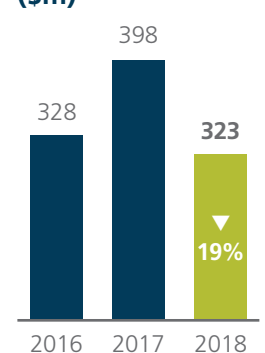
## Capital and equity placement

Challenger Life finished the year strongly capitalised with \$1.3 billion of excess regulatory capital. This represents 1.53 times the Prescribed Capital Amount (PCA) set by the Australian Prudential Regulation Authority (APRA), which is at the top end of Challenger's target range of 1.3 to 1.6 times.

## Normalised net profit after tax<sup>1</sup> (\$m)



## Statutory net profit after tax (\$m)



## Life performance

Life focuses on the retirement spending phase of superannuation by providing products that convert retirement savings into safe and secure income for life.

Total Life sales increased by 12% in 2018 to \$5.6 billion. With both strong sales and a reduction in the annuity maturity rate, Life's total net book growth increased by 37% to a record \$1.8 billion. This represents growth in Life's annuity and other policy liabilities of 15.0% for the year.

Life's average investment assets increased by 16% and Life's normalised earnings before interest and tax (EBIT) increased by 6% to \$563 million, which was less than the increase in average investment assets principally due to product diversification changing the mix of products sold.

A key driver of Life's performance is our success in expanding our customer base by broadening our products and distribution activities. Over recent years, we have developed a wide range of term and lifetime annuities, including our fastest growing product CarePlus, which helps meet the needs of people in aged care. We have further diversified with new institutional products and a successful partnership in Japan. Challenger annuities are expected to launch on BT's Panorama platform

Group assets under management up 16%

**\$81**<sub>bn</sub>

Normalised profit after tax<sup>1</sup>

**↑6%**

Regulatory capital above APRA's minimum requirement

**\$1.3**<sub>bn</sub>

<sup>1</sup> Normalised profit framework and a reconciliation to statutory net profit after tax is disclosed in Section 8 of the Operating and Financial Review in the Challenger 2018 Annual Report.

shortly, by which time they will be available on superannuation platforms used by two-thirds of Australia's financial advisers.

Challenger continues to focus on capturing growth opportunities in Japan, with the development of a new Australian dollar lifetime annuity for the Japanese market, in partnership with MS Primary. The partnership is progressing well and contributed 15% of Challenger's annuity sales for the year. During the year, Challenger opened a Tokyo office to support the strategic relationship with MS&AD and develop distribution opportunities.

## Funds Management performance

Funds Management focuses on the retirement savings phase of superannuation by providing products seeking to deliver superior investment returns.

Funds Management achieved net flows of \$5.3 billion for the year, with average funds under management (FUM) rising 19% to \$73.4 billion, delivering a 28% increase in EBIT to \$58 million.

We are one of Australia's fastest growing active fund managers, with our Fidante Partners business establishing new boutique managers and launching new investment strategies during the year and our Challenger Investment Partners business continuing to win third-party property and fixed income mandates.

Fidante Partners also announced plans to launch a series of Exchange Traded Funds (ETFs) for its boutique fund managers under the Fidante Partners ActiveX brand, starting with an active fixed income ETF expected to launch in the first half of 2019. These initiatives will improve access to Fidante funds for retail investors and help self managed superannuation funds diversify their investments.

## Update on retirement income reform

There has been significant focus on Government policy areas that affect retirees over the last year and Challenger has actively participated in processes to drive reform. Following the introduction of measures to enable a wider range of retirement income products in 2017, the Government developed new social security means test rules for these products to support their development and use. These new rules come into effect on 1 July 2019 and provide a strong foundation to further grow the use of lifetime income products.

Building on these reforms, the Government also announced in 2018 a new Retirement Income Framework that aims to significantly enhance the retirement phase of superannuation by placing more focus on the role of superannuation funds in providing members with reliable income for life.

These are positive developments that will help ensure lifetime income products, such as annuities, are an option for more Australians in retirement.

As a Board our aim is to deliver sustainable returns for our shareholders and build a solid foundation for future growth. I am confident we are well on track.

Thank you for your ongoing support and commitment to Challenger.



**Peter Polson**

Independent Chair  
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

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## Challenger Capital Notes distribution history

Distribution payment date	Cash distribution <sup>1</sup>	Total return <sup>1</sup>
25 August 2017	\$0.91	5.1350%
27 November 2017	\$0.92	5.1100%
26 February 2018	\$0.90	5.1300%
25 May 2018	\$0.87	5.1800%
27 August 2018	\$0.96	5.3350%

## Challenger Capital Notes 2 distribution history

Distribution payment date	Cash distribution <sup>1</sup>	Total return <sup>1</sup>
22 August 2017	\$1.63	6.1850%
22 November 2017	\$1.08	6.1050%
22 February 2018	\$1.08	6.1250%
22 May 2018	\$1.05	6.1650%
22 August 2018	\$1.12	6.3453%

<sup>1</sup> The cash distribution is the cash payment made on each \$100 Challenger Capital Note or Challenger Capital Note 2 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 divided by 365 days, applied to each \$100 Challenger Capital Note or Challenger Capital Note 2.