2018
Analyst Pack

Providing our customers with financial security for retirement

challenger.com.au
Challenger Limited ACN 106 842 371

challenger

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can be downloaded from Challenger's online Shareholder Centre

› **challenger.com.au/shareholder**

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Important note

Information presented in the 2018 (FY18) Analyst Pack is presented on an operational basis (rather than statutory) to reflect a management view of the business. Challenger Limited (ACN 106 842 371) also provides statutory reporting as prescribed under the *Corporations Act 2001*. The 2018 Annual Report is available from Challenger's shareholder centre at:

› **www.challenger.com.au/shareholder**

The Analyst Pack is not audited. The statutory net profit after tax as disclosed in the consolidated profit and loss (page 11) has been prepared in accordance with Australian Accounting Standards and the *Corporations Act 2001*. Challenger's external auditor, Ernst & Young, has reviewed the statutory net profit after tax as disclosed in the consolidated profit and loss. Normalised net profit after tax, as disclosed in the consolidated profit and loss (page 11) has been prepared in accordance with a normalised profit framework and has been disclosed in the Operating Financial Review section of the Directors' Report in the Challenger Limited 2018 Annual Report. The normalised net profit after tax has been subject to a review performed by Ernst & Young.

Any forward-looking statements included in this document are by nature subject to significant uncertainties, risks and contingencies, many of which are outside the control of, and are unknown to, Challenger, so that actual results or events may vary from those forward-looking statements, and the assumptions on which they are based.

Past performance is not an indicator of future performance. While Challenger has sought to ensure that information is accurate by undertaking a review process, it makes no representation or warranty as to the accuracy or completeness of any information or statement in this document. In particular, information and statements in this document do not constitute investment advice or a recommendation on any matter, and should not be relied upon.

FY18 financial highlights

Group	• Normalised net profit before tax $547m, up 8% • Normalised net profit after tax[1] $406m, up 6% • Statutory net profit after tax $323m, down 19% • Normalised EPS[2] 68.1 cents per share, down 1% • Statutory EPS 54.0 cents per share, down 24% • Net income $822m, up 7% • Expenses $268m, up 5% • Normalised cost to income ratio improved by 70 bps to 32.7% • Group assets under management $81.1bn, up 16% • Normalised return on equity 16.5% (pre-tax), down 180 bps • Full year dividend 35.5 cents per share (fully franked), up 3% • Normalised dividend payout ratio 52%
Life	• Cash Operating Earnings (COE) $670m, up 6% • COE margin 3.93%, down 36 bps from FY17 • Expenses $107m, up 7% • EBIT[3] $563m, up 6% • Total Life sales $5.6bn, up 12% • Total Life book growth $1.8bn (or 15.0% of opening liabilities), up 37% • Annuity sales $4.0bn, unchanged • Annuity book growth $1.4bn (or 13.5% of opening liabilities), up 55% • Investment assets $18.1bn, up 15% • Normalised Return on Equity 18.5% (pre-tax), down 250 bps • Prescribed Capital Amount (PCA) ratio 1.53 times, down from 1.57 times at FY17 • Common Equity Tier 1 (CET1) ratio 1.05 times, up from 1.01 times at FY17
Funds Management	• Net income $151m, up 13% • Expenses $93m, up 5% • EBIT[3] $58m, up 28% • Net flows $5.3bn, down 15% • Funds Under Management (FUM) $78.0bn, up 17% • Return on Equity 29.4% (pre-tax), up 460 bps

[1] Normalised net profit after tax excludes investment experience, being gains and losses on Life's investment assets and policy liabilities and net new business strain; and significant items (refer to page 54 for more detail on investment experience).
[2] Earnings Per Share (EPS).
[3] Earnings before interest and tax (EBIT).

Market overview and outlook

Challenger is an investment management company with a vision to provide its customers with financial security for retirement. Challenger has two businesses, Life and Funds Management, which both provide products for Australia's fast-growing superannuation system, and are expanding into international markets.

Australia's modern superannuation system started in 1992 and is now the fourth largest pension system globally[1]. It is worth around $2.6 trillion today and is growing at twice the rate of global pension markets. Australia's superannuation assets have increased by 8% CAGR over the past 10 years.

Growth in Australia's superannuation system is underpinned by mandatory contributions, which are scheduled to increase from 9.5% of gross salaries to 12.0% by 2025. The superannuation system is forecast to grow from $2.6 trillion today to over $10 trillion by 2035[2]. Growth in the superannuation system is also supported by changing demographics and the Government enhancing the retirement phase of superannuation.

Both Life and Funds Management are expected to benefit from growth in Australia's superannuation system.

Life

Life focuses on the retirement spending phase of superannuation by providing products that convert retirement savings into safe and secure income. Challenger Life is Australia's leading provider of annuities[3], providing reliable guaranteed[4] incomes to 75,000 Australian retirees.

The retirement spending phase of superannuation is expected to grow strongly over the next 20 years, driven by demographic changes and maturing of the system.

The number of Australians over the age of 65, which is Life's target market, is expected to increase by ~70% over the next 20 years[5].

Reflecting the demographic changes underway, and growth in Australia's superannuation system, the annual transfer from the retirement savings phase to the retirement spending phase is estimated to be ~$60bn[6] in 2018 and is growing strongly. Annuities currently capture less than 5% of the annual transfer to the retirement phase.

There is growing recognition that retirees need to take a different approach to investing in retirement. As retirees transition from Government funded aged pensions to private pensions, retirees are demanding safe, secure retirement income products that convert savings to income and provide financial security. Annuities address these retiree needs.

The super system is successfully helping Australians build savings for their retirement. Australians now have meaningful super balances when they retire, with the median balance being over $250,000[7], despite the system only being in place for half the working life of today's retirees.

There is a range of Government retirement income regulatory reforms currently underway (refer to page 29 for more detail) designed to enhance the retirement phase and better align it with the overall objective of the superannuation system – providing income in retirement to substitute or supplement the age pension. These reforms provide a significant opportunity to increase the proportion of retirement savings invested in longevity products, including annuities.

Life is diversifying its range of products and expanding its distribution relationships in Australia and in Japan.

In Australia, Life is launching new products and broadening access to them by making annuities available via leading investment and administration platforms. Following the launch of Challenger annuities on the BT platform[8], platform relationships will provide two thirds of Australian financial advisers with access to Challenger annuities via an investment and administration platform.

Challenger is recognised as a product innovator and has won the Association of Financial Advisers Annuity Provider of the Year for the last 10 consecutive years. Challenger is also recognised by 93%[9] of advisers as an Australian leader in retirement incomes.

In Japan, Life commenced an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a subsidiary of MS&AD Insurance Group Holdings Inc. (MS&AD) in November 2016. MS Primary is a leading provider of Australian dollar denominated annuity products in Japan (refer to page 28 for more detail). The relationship with MS Primary provides Challenger with access to Japan's foreign currency annuity market.

Japan has one of the world's most rapidly ageing populations and Japan has a very low domestic interest rate environment, which is making higher returning foreign currency annuities popular. Life is building on the MS Primary annuity relationship. In FY19, Challenger will reinsure an Australian dollar 20-year fixed rate annuity and an Australian dollar lifetime annuity (refer to page 28 for more detail).

MS Primary is a key Challenger annuity distribution partner and in recognition of the importance of the relationship, in August 2017 Challenger formed a strategic relationship with its parent MS&AD. The strategic relationship increases Challenger's access to the Japanese market and broadens its existing international footprint, whilst providing opportunities for both MS&AD and Challenger. Through an equity placement and subsequent on-market purchases, MS&AD currently holds a 10% equity interest in Challenger.

As Australia's leading provider of annuities, Life is expected to continue to benefit from overall growth in Australia's superannuation system and regulatory reforms designed to enhance the retirement phase. Life is also expected to benefit from diversifying its products and distribution through the MS Primary annuity relationship.

[1] Willis Towers Watson Global Pension Study 2017.
[2] Rice Warner 2017 superannuation projections.
[3] Strategic Insights – March 2018.
[4] The word 'guaranteed' means payments are guaranteed by Challenger Life Company Limited from the assets of its relevant statutory fund.
[5] Australian Bureau of Statistics population projections.
[6] Australian Taxation Office.
[7] Australian Prudential Regulation Authority (APRA) June 2017.
[8] Launch expected in the September 2018 quarter.
[9] Market Pulse Adviser Study December 2017.

Funds Management

Funds Management focuses on the retirement savings phase of superannuation by providing products seeking to deliver superior investment returns. Funds Management is one of the fastest growing active Australian funds managers.

Challenger's Funds Management business is growing significantly faster than the broader market and is attracting superior net flows.

This superior growth in funds under management can be attributed to the strength of Challenger's retail and institutional distribution teams, a market leading business model that focuses on investor alignment and strong investment performance.

Challenger’s Fidante Partners' business model involves minority equity interests in seperately branded, boutique fund management firms, with Challenger providing the distribution, administration and business support, leaving investment managers to focus on managing investment portfolios.

This strong investor alignment is driving superior long-term investment performance, with 96% of Funds Management funds outperforming their benchmark[1]. This long-term performance track record is underpinning net flows, with $5.3 billion of net flows in FY18, representing 8% of opening FUM.

Following the success of Challenger's Fidante Partners business model in Australia, it is being replicated in Europe, providing access to the United Kingdom funds management market, and providing global distribution opportunities for existing investment managers. As part of its expansion, Fidante Partners Europe is attracting new international boutique managers, with two US-based boutiques joining Fidante Partners Europe in FY18.

Funds Management is also expanding its presence in Japan. A Tokyo office has been established to support the MS&AD strategic relationship and to develop distribution opportunities in the region. A Japanese real estate funds management licence has been granted and the management of Life’s portfolio of retail Japanese properties has been insourced.

Funds Management also includes Challenger Investment Partners (CIP), an institutional manager that originates and manages assets for leading global and Australian institutions, including Challenger Life. CIP clients benefit from the broad product offering and market insights CIP gains through its experienced team and scale of its investment business.

Funds Management is expected to continue to benefit from the overall growth in Australia’s superannuation system, Challenger's distribution capability, superior long-term investment performance, and international expansion.

[1] Percentage of Funds Management funds meeting or exceeding performance benchmark over five years.

Vision and strategy

Challenger's vision is to provide its customers with financial security for retirement. Challenger has four strategic pillars to ensure it achieves its vision over the long term. The four strategic pillars are:

- increase the Australian retirement savings pool allocation to secure and stable incomes;
- be recognised as the leader and partner of choice in retirement income solutions with a broad product offering;
- provide customers with relevant investment strategies exhibiting consistently superior performance; and
- deliver superior outcomes to customers and shareholders through a highly engaged, diverse and agile workforce committed to sustainable business practices and a strong risk and compliance culture.

To provide our customers with financial security for retirement

Increase the Australian retirement savings pool allocation to secure and stable incomes

Be recognised as the leader and partner of choice in retirement income solutions with a broad product offering

Provide customers with relevant investment strategies exhibiting consistently superior performance

Deliver superior outcomes to customers and shareholders through a highly engaged, diverse and agile workforce committed to sustainable business practices and a strong risk and compliance culture

2018 strategic progress

Grow allocation to secure and stable retirement incomes

Increase the Australian retirement savings pool allocation to secure and stable incomes

Annuities currently capture less than 5% of the annual transfer from the retirement savings (accumulation) to the retirement spending (retirement) phase. Challenger is focused on growing the allocation of Australian retirement savings allocated to secure and stable incomes.

FY18 progress includes:

Life sales

- $5.6bn of total Life sales, up 12% on FY17;
- $4.0bn of annuity sales, unchanged on FY17; and
- $1.6bn of other Life sales, up 65% on FY17.

Life sales mix and focus on long-term products

Challenger's annuity sales mix is evolving to long-term products. FY18 long-term annuity sales represented 36% of total annuity sales, double the level achieved only two years ago. Long-term sales embed more value for shareholders as they lengthen the annuity book tenor, improve the maturity profile and typically enhance return on equity.

Tools for financial advisers

Challenger's market leading retirement illustrator was launched in FY17 to support advisers and the paraplanning process. The retirement illustrator provides scenario modelling to demonstrate the benefits of partial annuitisation. In FY18, Challenger's retirement illustrator was enhanced and made available to a number of superannuation funds via white label arrangements.

Superannuation reforms engagement and advocacy

The Australian Government is undertaking a range of superannuation reforms aimed at enhancing the retirement phase of superannuation to better align it with the overall objective of the system – providing income in retirement to substitute or supplement the age pension.

In FY18, the Government finalised the means test review for lifetime income streams, with new rules to apply from 1 July 2019. The new means test rules support the development of innovative products to help retirees manage the risk of outliving their savings, while ensuring a fair and consistent means test treatment of all retirement income products. The new means test rules also pave the way for the development of Comprehensive Income Products for Retirement (CIPRs).

The Government has also announced a new Retirement Income Framework to increase focus on the retirement phase of superannuation and increase flexibility and choice for retirees to help boost retiree living standards. The first stage of the framework is the introduction of a Retirement Income Covenant requiring trustees to develop a retirement strategy to help members achieve their retirement income objectives.

Refer to page 29 for more detail on the retirement income regulatory reforms.

Maintaining thought leadership position

As a key thought leader in retirement incomes in Australia, Challenger works with industry and consumer organisations and Government to develop policy outcomes that will be beneficial for all older Australians.

In FY18, Challenger partnered with the National Seniors Association on research to understand attitudes to the financial aspects of retirement. This research was widely reported and referenced by media and Government.

Challenger's dedicated research function also produced a number of research papers including a major report titled Retirement Really is Different. These papers were shared with a wide range of stakeholders and have driven extensive discussion.

Throughout the year Challenger also directly participated in a number of consultation processes to contribute to effective policy setting, such as the means test rules discussed above.

In the latest Marketing Pulse Adviser Study, 77% of advisers recognised Challenger as a retirement income thought leader.

Launch of Deferred Lifetime Annuities (DLAs)

On 1 July 2017, new retirement income rules were implemented, providing a framework for product innovation, including Deferred Lifetime Annuities (DLAs). DLAs are products providing regular and reliable income commencing after a deferral period. DLAs are expected to provide a building block for CIPRs and help increase Australian retirement savings allocated to secure and stable incomes.

Challenger launched a DLA in September 2017 and was the first Australian life insurer to offer a DLA. Future DLA sales are expected to be supported by the new means test rules for lifetime income streams, commencing on 1 July 2019.

Strong growth in CarePlus sales

CarePlus is a lifetime annuity that is specifically designed for clients in aged care. It helps manage aged care costs by providing regular payments for life as well as providing peace of mind that 100% of the amount invested will be paid on death to either a nominated beneficiary or to the estate.

CarePlus sales continue to benefit from demographic trends with approximately 300 older Australians entering home or residential care each day. In FY18, CarePlus sales increased by 63% and represented 8% of Challenger's FY18 annuity sales. CarePlus sales are benefiting from an ageing population and advisers having a greater understanding of the product and the benefits it provides their aged care clients. The number of advisers writing CarePlus during FY18 increased by 32%.

Be the market leader and partner of choice in retirement income solutions

Be recognised as the leader and partner of choice in retirement income solutions with a broad product offering

Challenger is the market leader in retirement incomes with 73%[1] annuity market share. However, annuities currently capture less than 5% of the annual transfer from the savings phase of superannuation to the retirement phase.

Challenger's strategy includes being the partner of choice for superannuation funds, wealth managers and platforms for providing retirement income solutions.

FY18 progress includes:

Leading adviser and consumer ratings

Amongst Australian financial advisers, Challenger continues to be the most recognised retirement income brand.

Challenger's brand awareness amongst financial advisers increased to 89%[2] in December 2017, up from 85% in December 2016.

Challenger continues to be recognised by financial advisers as the leader in retirement income, with 93%[2] of financial advisers either agreeing or strongly agreeing with this statement. Challenger has maintained its leading position with a score 30 percentage points above its nearest competitor.

In 2018, Wealth Insights undertook an analysis to compare the service level of Challenger Annuities to the broader Australian funds management market. When compared to the market, Challenger annuities rated number one across six key categories, including Overall Adviser Satisfaction (3rd consecutive year); BDM Team (7th consecutive year); Adviser Contact Centre (3rd consecutive year); Image and Reputation (3rd consecutive year); Technical Services (3rd consecutive year) and Website (2nd consecutive year). Not only were number one ratings retained for each category, Challenger’s 2018 score increased in all six categories.

Increased product access via investment and administration platforms

Challenger's strategic priorities include making its annuity products available on leading investment and administration platforms, allowing financial advisers and their customers easy and efficient access to Challenger annuities.

By making Challenger annuities available via investment and administration platforms, advisers and superannuation funds can easily design products that combine lifetime income streams with other products, such as account-based pensions.

In September 2017, Challenger's full range of annuity products were made available via AMP's adviser portal to their retail and corporate superannuation customers. In order to support Challenger annuities and the advice process, Challenger's retirement income tools and calculators have been made available to AMP advisers. AMP also provides retirement model portfolio guidance to its advisers. Following the launch on the AMP platform, 80% of Challenger annuity sales via the AMP adviser portal are lifetime annuities and there has been a significant increase in the number of AMP advisers writing Challenger annuities.

Challenger is also making its annuities available on the new BT Panorama platform. In FY18, Challenger completed the build and expects to launch on BT Panorama in the September 2018 quarter.

Leverage MS&AD strategic relationship and expand into Japanese market

In November 2016, Challenger commenced issuing Australian dollar fixed rate annuities with a 20-year term in order to support a reinsurance agreement with MS Primary. MS Primary was attracted to Challenger's ability to manage long-term assets and liabilities, Challenger's approach to risk management and product innovation experience.

The MS Primary annuity relationship contributed 15% of Challenger's FY18 annuity sales, in line with Challenger’s expectation of ~$600m for the FY18 year.

In FY18, Challenger and MS Primary have developed a new Australian dollar lifetime annuity product for the Japanese market. In FY19, Challenger will reinsure both the initial Australian dollar 20-year fixed term product and a new Australian dollar lifetime annuity.

[1] Strategic Insights – March 2018.

[2] Marketing Pulse Adviser Study – December 2017.

Challenger has opened a Tokyo office in order to support the MS&AD relationship and to develop distribution opportunities across the region.

Given the success of the annuity relationship with MS Primary, in August 2017 Challenger formed a strategic relationship with MS&AD in order to increase access to the Japanese market and provide opportunities for both Challenger and MS&AD. Challenger and MS&AD are exploring a range of business opportunities.

Provide relevant and superior investment strategies for customers

Provide customers with relevant investment strategies exhibiting consistently superior performance

Challenger is focused on providing relevant investment strategies that exhibit superior investment performance in order to help build retirement savings.

FY18 progress includes:

Maintaining superior investment performance

Funds Management has a long track record of achieving superior investment performance, which is helping attract superior net flows. Over the year to 30 June 2018, 91%[1] of Funds Management funds[2] outperformed their benchmark. Over five years 96%[1] of funds have outperformed their benchmark.

For Fidante Partners, over the past 10 years, 86% of funds have achieved either first or second quartile investment performance[3], meaning most funds are performing well above average. Over one year, 81% of funds achieved first or second quartile investment performance.

Adding boutiques and strategies

In 2H18, Challenger announced two new boutique partnerships. Garelick Capital Partners, a Boston-based equities manager and Latigo Partners a New York-based specialist event-driven credit manager. Garelick Capital Partners and Latigo Partners form part of Fidante Partners Europe (refer to page 50 for more detail) and manage more than $1 billion of FUM as at 30 June 2018.

During FY18, six new investment strategies were added to existing boutique managers, including:

- Alphinity relaunched the Australian Equity Sustainable Share Fund with a new investment process and ESG advisory board;
- Ardea Real Outcome strategy for retail clients;
- Ardea Diversified Bond Fund for institutional clients;
- Avenir Capital made available to retail investors;
- Lennox Capital microcap strategy; and
- Merlon Capital Partners Concentrated Value Strategy for retail investors.

Highly rated investment products

Fidante Partners' investment managers and funds are highly rated by external asset consultants. For Fidante Partners' funds that are rated by asset consultants:

- 36% of ratings are the top rating (e.g. 'Highly Recommended') compared to an average of approximately 10% across the Australian funds management industry; and
- 95% of ratings have a 'buy' rating compared to an average of approximately 70% across the Australian funds management industry.

[1] Percentage of Fidante Partners' funds meeting or exceeding performance benchmarks over one and five years.
[2] Includes both Fidante Partners and Challenger Investment Partners (CIP).
[3] Mercer June 2018.

Expanding capability into ETF market

There is strong demand from investors for simple and easy to access liquid investment products. Exchange Traded Funds (ETFs) have experienced very strong growth as they provide low cost, diversified investments in a liquid form. ETFs have traditionally focused on passive or factor-specific investments; however, Funds Management has identified an opportunity to expand ETF usage to active manager products.

During FY18, Funds Management commenced development of the Fidante ActiveX Series, which is expected to launch in 1H19. The Fidante ActiveX ETF Series will include Australia's first active fixed income ETF and there is an opportunity to add Funds Management's managers over time.

Sustainable business practices to deliver superior outcomes

Deliver superior outcomes to customers and shareholders through a highly engaged, diverse and agile workforce committed to sustainable business practices and a strong risk and compliance culture

Challenger believes maintaining a highly engaged, diverse and agile workforce committed to sustainable business practices and a strong risk and compliance culture will provide customers and shareholders with superior outcomes.

FY18 progress includes:

Employee engagement

A highly engaged workforce helps deliver superior shareholder outcomes. Challenger's 2017 employee engagement score was five percentage points above the Willis Tower Watson global high performing company norm. Challenger's next employee engagement survey is scheduled for March 2019.

Diversity

Challenger seeks to create an inclusive workforce and values the capability and experience that diversity brings to the organisation. To encourage greater representation of women at senior levels of the organisation, Challenger continues to develop initiatives targeted at improving gender equality, including setting gender diversity targets. Diversity targets were set in December 2015 and Challenger has already exceeded its mid-term targets and is on track to exceed its FY20 targets.

In the FY18 year, the number of women in senior management roles increased by 5% to 38% and is ahead of Challenger's FY18 diversity target. Challenger also launched the 'Women Leading @ Challenger' program, aimed at further increasing women in leadership.

Innovation and efficiency through agility

Challenger is focused on ensuring its business is as efficient as possible. A key priority has been embedding an Agility program right across the business.

Since launching the program two years ago, Agility has become an integral part of how Challenger's employees work and all employees are encouraged to implement changes that save time, reduce risk, or assist Challenger's growth by focusing on scalability.

Of the 261 initiatives that have been implemented and measured so far, 79% resulted in time saving, 64% in reduced risk, and 52% improved the scalability of the process.

Maintain superior cost to income ratio

Challenger's business is highly scalable and efficient. In FY18, Challenger's normalised cost to income ratio was 32.7%, a record financial year low and toward the mid-point of Challenger's guidance range (30% to 34%).

Over the last decade, Challenger's normalised cost to income ratio has fallen from 47.6% to 32.7%, down 15 percentage points.

Challenger maintains one of the industry's leading cost to income ratios and is 15 percentage points below the industry average[1].

Enhancing Environmental Sustainability Governance (ESG) capability

As one of the largest investment managers in the Asia-Pacific region, Challenger recognises its responsibilities in relation to sustainability. Challenger has established a clear sustainability strategy and significantly enhanced its sustainability reporting in FY18, including independent assurance of emission reporting.

Challenger's FTSE4Good score increased by 52% to 4.1 over the past two years and Challenger was included in the Dow Jones Sustainability Index.

Challenger has adopted an integrated investment management approach to deliver responsible investment outcomes and believes there are links between long-term sustainable returns and the quality of an organisation's ESG practices.

Challenger is a signatory to the Principles for Responsible Investment (PRI) and in March 2018, lodged an annual PRI assessment report.

Challenger has a Board-approved Responsible Investment policy and Challenger's Board, relevant leadership team members, and all investment managers and their teams are responsible for the effective management and integration of ESG considerations in the investment decision-making process.

In order to support Fidante Partners' and CIP's ESG approach, during FY18 a dedicated ESG specialist was hired to support Challenger's investment managers on ESG related matters.

In March 2018, Alphinity Investment Management, one of Fidante Partners' boutique managers refreshed their Socially Responsible Share Fund to focus on companies that can make a positive impact on society. The Alphinity Sustainable Share Fund won Responsible Investments Fund Manager of the Year at the 2018 Money Management/Lonsec Fund Manager Awards.

[1] Includes Australian and New Zealand Banking Corporation, AMP, Bank of Queensland, Bendigo and Adelaide Bank, Commonwealth Bank of Australia, IOOF, Macquarie Bank, Magellan Financial Group, National Australia Bank, Pendal Group, Perpetual and Westpac Banking Corporation.

Key performance indicators

	FY18	FY17	FY16	2H18	1H18	2H17	1H17	2H16	1H16
Earnings									
Normalised NPBT ($m)	547.3	505.0	467.4	272.7	274.6	250.9	254.1	231.0	236.4
Normalised NPAT ($m)	406.1	384.9	361.7	198.2	207.9	188.3	196.6	179.6	182.1
Statutory NPAT ($m)	322.5	397.6	327.7	127.1	195.4	196.1	201.5	93.4	234.3
Underlying operating cash flow ($m)	197.4	299.9	297.1	143.6	53.8	131.4	168.5	149.7	147.4
Normalised cost to income ratio (%)	32.7%	33.4%	34.6%	33.2%	32.1%	33.9%	32.9%	35.4%	33.8%
Normalised effective tax rate (%)	25.8%	23.8%	22.6%	27.3%	24.3%	24.9%	22.6%	22.3%	23.0%
Earnings per share (cents)									
Basic – normalised	68.1	68.5	64.6	32.9	35.2	33.5	35.0	32.0	32.6
Basic – statutory	54.0	70.7	58.5	21.1	33.1	34.9	35.8	16.6	41.9
Diluted – normalised	64.2	65.8	60.9	30.9	33.8	32.1	33.3	30.3	30.5
Diluted – statutory	52.2	67.8	55.4	20.9	31.9	33.4	34.1	16.3	39.0
Return on equity (%)									
Normalised ROE – pre-tax	16.5%	18.3%	17.8%	16.1%	16.8%	18.0%	18.7%	17.4%	18.1%
Normalised ROE – post-tax	12.2%	14.0%	13.7%	11.7%	12.7%	13.5%	14.5%	13.6%	14.0%
Statutory ROE – post-tax	9.7%	14.4%	12.5%	7.5%	11.9%	14.0%	14.8%	7.1%	18.0%
Capital management									
Net assets – average[1] ($m)	3,323	2,754	2,631	3,419	3,249	2,818	2,694	2,664	2,592
Net assets – closing ($m)	3,485	2,888	2,681	3,485	3,470	2,888	2,781	2,681	2,696
Net assets per basic share ($)	5.79	5.14	4.80	5.79	5.75	5.14	4.95	4.80	4.80
Net tangible assets ($m)	2,893	2,300	2,097	2,893	2,878	2,300	2,192	2,097	2,111
Net tangible assets per basic share ($)	4.81	4.09	3.75	4.81	4.77	4.09	3.90	3.75	3.75
Dividend (cps)	35.5	34.5	32.5	18.0	17.5	17.5	17.0	16.5	16.0
Dividend franking (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Normalised dividend payout ratio (%)	52.1%	50.4%	50.3%	54.7%	49.7%	52.2%	48.6%	51.6%	49.1%
Sales, net flows and assets under management									
Life annuity sales ($m)	4,000.7	4,011.2	3,351.2	1,711.2	2,289.5	1,815.1	2,196.1	1,710.1	1,641.1
Other Life sales ($m)	1,554.9	941.2	998.5	520.4	1,034.5	378.9	562.3	588.8	409.7
Total Life sales ($m)	5,555.6	4,952.4	4,349.7	2,231.6	3,324.0	2,194.0	2,758.4	2,298.9	2,050.8
Life annuity flows ($m)	1,392.7	900.4	740.4	634.5	758.2	451.5	448.9	469.9	270.5
Life annuity book ($m)	11,728	10,322	9,559	11,728	11,116	10,322	9,785	9,559	8,868
Life annuity book growth (%)	13.5%	9.4%	8.5%	6.2%	7.3%	4.7%	4.7%	5.4%	3.1%
Total Life flows ($m)	1,796.3	1,312.9	1,068.3	848.4	947.9	469.5	843.4	721.2	347.1
Total Life book[2] ($m)	13,863	12,010	10,874	13,863	13,025	12,010	11,418	10,874	9,904
Total Life book growth (%)	15.0%	12.1%	11.1%	7.1%	7.9%	4.3%	7.8%	7.5%	3.6%
Funds Management – net flows[3] ($m)	5,301.2	6,220.6	(2,517.2)	1,366.9	3,934.3	3,003.5	3,217.1	1,839.2	(4,356.4)
Total Group AUM ($m)	81,143	69,988	60,051	81,143	76,523	69,988	64,705	60,051	57,617
Other									
Headcount – closing FTEs	676	655	635	676	682	655	632	635	618
Weighted average number of basic shares on issue (m)	596.7	562.2	560.2	602.2	591.1	562.1	562.3	561.2	559.1
Number of basic shares on issue (m)	601.7	561.9	558.8	601.7	603.3	561.9	562.3	558.8	562.2
Share price closing ($)	11.83	13.34	8.63	11.83	14.03	13.34	11.24	8.63	8.72

[1] Net assets – average calculated on a monthly basis.
[2] Total Life book includes the Life annuity book, Guaranteed Index Return (GIR) and Challenger Index Plus Fund liabilities.
[3] Funds Management 1H16 and FY16 net flows include $5.4bn derecognition of Kapstream FUM following the sale of Kapstream in July 2015.

Consolidated profit and loss

$m	FY18	FY17	FY16	2H18	1H18	2H17	1H17	2H16	1H16
Cash earnings	539.1	526.4	491.9	262.7	276.4	261.1	265.3	247.4	244.5
Normalised capital growth	130.5	105.0	100.5	70.8	59.7	53.9	51.1	52.1	48.4
Normalised Cash Operating Earnings (COE)	**669.6**	**631.4**	**592.4**	**333.5**	**336.1**	**315.0**	**316.4**	**299.5**	**292.9**
Net fee income	151.2	134.0	127.7	79.2	72.0	68.7	65.3	60.6	67.1
Other income	1.0	0.8	1.0	0.5	0.5	0.4	0.4	0.4	0.6
Total net income	**821.8**	**766.2**	**721.1**	**413.2**	**408.6**	**384.1**	**382.1**	**360.5**	**360.6**
Personnel expenses	(187.8)	(179.3)	(172.8)	(96.8)	(91.0)	(91.4)	(87.9)	(89.0)	(83.8)
Other expenses	(80.6)	(76.6)	(76.8)	(40.5)	(40.1)	(38.8)	(37.8)	(38.7)	(38.1)
Total expenses	**(268.4)**	**(255.9)**	**(249.6)**	**(137.3)**	**(131.1)**	**(130.2)**	**(125.7)**	**(127.7)**	**(121.9)**
Normalised EBIT	**553.4**	**510.3**	**471.5**	**275.9**	**277.5**	**253.9**	**256.4**	**232.8**	**238.7**
Interest and borrowing costs	(6.1)	(5.3)	(4.1)	(3.2)	(2.9)	(3.0)	(2.3)	(1.8)	(2.3)
Normalised profit before tax	**547.3**	**505.0**	**467.4**	**272.7**	**274.6**	**250.9**	**254.1**	**231.0**	**236.4**
Normalised tax	(141.2)	(120.1)	(105.7)	(74.5)	(66.7)	(62.6)	(57.5)	(51.4)	(54.3)
Normalised profit after tax	**406.1**	**384.9**	**361.7**	**198.2**	**207.9**	**188.3**	**196.6**	**179.6**	**182.1**
Investment experience after tax	(76.0)	12.7	(56.1)	(63.5)	(12.5)	7.8	4.9	(86.2)	30.1
Significant items after tax[1]	(7.6)	-	22.1	(7.6)	-	-	-	-	22.1
Statutory net profit after tax	**322.5**	**397.6**	**327.7**	**127.1**	**195.4**	**196.1**	**201.5**	**93.4**	**234.3**
Performance analysis									
Normalised earnings per share – basic (cents)	68.1	68.5	64.6	32.9	35.2	33.5	35.0	32.0	32.6
Shares for basic EPS calculation (m)	596.7	562.2	560.2	602.2	591.1	562.1	562.3	561.2	559.1
Normalised cost to income ratio (%)	32.7%	33.4%	34.6%	33.2%	32.1%	33.9%	32.9%	35.4%	33.8%
Normalised tax rate (%)	25.8%	23.8%	22.6%	27.3%	24.3%	24.9%	22.6%	22.3%	23.0%
Total net income analysis									
Cash earnings (Life)	65.6%	68.7%	68.2%	63.6%	67.7%	68.0%	69.4%	68.6%	67.8%
Normalised capital growth (Life)	15.9%	13.7%	14.0%	17.1%	14.6%	14.0%	13.4%	14.5%	13.4%
Net fee income (Funds Management)	18.4%	17.5%	17.7%	19.2%	17.6%	17.9%	17.1%	16.8%	18.6%
Other income (Corporate)	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.2%
Normalised EBIT by division									
Life	562.7	531.2	499.8	279.7	283.0	264.2	267.0	250.9	248.9
Funds Management	57.9	45.1	37.4	30.8	27.1	24.4	20.7	15.8	21.6
Corporate	(67.2)	(66.0)	(65.7)	(34.6)	(32.6)	(34.7)	(31.3)	(33.9)	(31.8)
Normalised EBIT	**553.4**	**510.3**	**471.5**	**275.9**	**277.5**	**253.9**	**256.4**	**232.8**	**238.7**

[1] 2H18 significant items (after tax) represents $14m (after tax) of one-off expenses, including the impairment of residual software and a Fidante Partners boutique following its closure and restructure costs, offset by $6m (after tax) of one-off revenue including partial writeback of deferred consideration in respect of the acquisition of Fidante Partners Europe. 1H16 significant items (after tax) primarily represent the gain on sale of Challenger's equity investment in Kapstream, offset by boutique impairments and office relocation costs.

Consolidated profit and loss

Normalised net profit after tax

FY18 normalised profit after tax was $406m and increased by $21m (6%) from $385m in FY17. The increase in normalised profit after tax includes a $43m (8%) increase in EBIT, partially offset by a $1m increase in interest and borrowing costs, and a $21m increase in normalised tax.

The increase in EBIT primarily reflects earnings from higher Group assets under management and Funds Management performance fees, which increased net income by $56m (7%), partially offset by a $13m (5%) increase in expenses.

Normalised earnings per share (EPS)

Normalised EPS decreased by 0.6% from 68.5 cps in FY17 to 68.1 cps in FY18. The decrease in normalised EPS reflects higher normalised profit after tax (up 6%), offset by a 6% increase in the number of weighted average shares on issue following the $500m equity placement to MS&AD in August 2017 (refer to page 28 for more detail).

Net income

Net income increased by $56m (7%) in FY18 due to:

- Life Cash Operating Earnings (COE) increasing by $38m (up 6%); and
- Funds Management fee income increased $17m (up 13%), benefiting from an increase in average Funds Under Management (FUM) (up 19%) and increased performance fees.

Expenses

FY18 total expenses were $268m, up $13m (5%) on FY17. The increase in expenses primarily relate to higher personnel costs (up $9m or 5%), from an increase in employee numbers and general salary increases. The number of full time equivalent (FTE) employees at 30 June 2018 (FY18) was 676 employees and increased by 3% on FY17, with employees added to both Life and Funds Management to support business growth.

The FY18 normalised cost to income ratio decreased by 70 bps to a record financial year low of 32.7% and is toward the mid-point of Challenger's normalised cost to income ratio guidance. Challenger’s normalised cost to income guidance was lowered to between 30% and 34% at the beginning of FY18.

Challenger has a highly scalable business and is one of Australia's most efficient financial services companies. Over the past 10 years, Challenger's normalised cost to income ratio has fallen by 15 percentage points and is currently 15 percentage points lower than the average for Australian banks and diversified financial companies[1].

Normalised EBIT

FY18 normalised EBIT was $553m and increased by $43m (8%) from $510m in FY17. Life EBIT increased by $31m (6%), Funds Management EBIT increased by $13m (28%) and Corporate EBIT decreased by $1m (2%).

The increase in Life EBIT (up 6%) reflects higher Life average investment assets, partially offset by a 36 bps reduction in Life's COE margin (refer to page 23 for more detail).

The increase in Funds Management EBIT (up 28%) reflects higher average FUM (up 19%), higher performance fees (up $17m), partially offset by lower Fidante Partners Europe capital raising transaction fees (down $12m).

Corporate EBIT decreased by $1m (2%) due to higher expenses, which increased by $1m.

Normalised Return on Equity (ROE)

FY18 normalised ROE was 16.5% (pre-tax) and decreased by 180 bps from FY17. The reduction in normalised ROE was due to higher levels of capital following the equity placement to MS&AD in August 2017. As a result, Group average net assets increased by $0.6bn (21%) to $3.3bn.

Challenger targets a pre-tax normalised ROE of 18% over the medium term. Normalised ROE is temporarily below this target due to higher capital levels and is expected to increase from 16.5% in FY18 and trend toward the 18% target over the medium term.

Normalised tax

Normalised tax was $141m in FY18, up $21m on FY17. Higher normalised tax reflects higher EBIT (up $43m) and a higher normalised tax rate.

The FY18 normalised tax rate was 25.8%, up from 23.8% in FY17. The increase in the normalised tax rate was mainly due to interest payments for both Challenger Capital Notes and Challenger Capital Notes 2 (refer to page 18 for more detail) not being tax deductible as they include a franked component as part of the distribution and lower offshore earnings which are taxed at rates below the Australian corporate tax rate of 30%.

For FY19, Challenger expects the normalised tax rate to increase by between 1% and 2% to be between 26% and 28%, due to a forecast increase in the proportion of domestic earnings (taxed at 30%) relative to offshore earnings (taxed at rates below 30%).

[1] Includes Australian and New Zealand Banking Corporation, AMP, Bank of Queensland, Bendigo and Adelaide Bank, Commonwealth Bank of Australia, IOOF, Macquarie Bank, Magellan Financial Group, National Australia Bank, Pendal Group, Perpetual and Westpac Banking Corporation.

Investment experience after tax

Challenger Life is required by Australian accounting standards to value investment assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on investment assets and liabilities being recognised in the profit and loss. Challenger is generally a long-term holder of assets, due to them being held to match the term of life contract liabilities. As a result, Challenger takes a long term view of the expected capital growth of the portfolio rather than focusing on short term movements.

Changes in macroeconomic variables impact the value of Life's assets and liabilities, with the impact included as part of investment experience.

Investment experience also includes new business strain, being the requirement to apply the risk-free discount rate plus an illiquidity premium to value annuity liabilities.

Investment experience relates to the Life business and further details are disclosed as part of Life's financial results.

FY18 investment experience was a loss of $76m (after tax). Refer to page 25 for more detail.

Significant items

Significant items were negative $8m (after tax) in FY18 and represent non-recurring income and expense items.

The one-off expenses of $14m relate to the impairment of capitalised software, restructure costs and an impairment charge following the closure of Tempo Asset Management, a Fidante Partners boutique.

The one-off revenue of $6m represents the partial writeback of deferred consideration associated with the acquisition of Fidante Partners Europe.

Statutory net profit after tax

Statutory net profit after tax includes after tax investment experience and significant one-off items.

Statutory net profit after tax in FY18 was $323m, down $75m (19%) from $398m in FY17. The decrease in statutory net profit after tax reflects higher normalised profit after tax (up $21m), offset by lower after tax investment experience (down $89m) and significant items (down $8m).

Dividends

FY18 dividend

The Board has declared a final FY18 dividend of 18.0 cps (fully franked), bringing the full year dividend to 35.5 cps (fully franked), which was 3% higher than the FY17 dividend. The higher dividend reflects the 6% increase in normalised net profit after tax offset by a higher number of shares on issue following the MS&AD equity placement.

Dates for the final FY18 dividend are as follows:

- ex-date: 31 August 2018;
- record date: 3 September 2018;
- final DRP election date: 4 September 2018; and
- dividend payment date: 26 September 2018.

The FY18 normalised dividend payout ratio was 52.1% which is above Challenger's normalised dividend payout ratio guidance of between 45% and 50% of normalised profit after tax. With a Dividend Reinvestment Plan in place (refer below), the effective cash dividend payout ratio is expected to reduce by approximately 2% to 50%.

Challenger's franking account balance at 30 June 2018 was $133m.

Dividend Reinvestment Plan

Challenger operates a Dividend Reinvestment Plan (DRP), providing an effective way for shareholders to reinvest their dividends and increase their shareholding without incurring transaction costs.

The DRP participation rate for the interim FY18 dividend (paid in March 2018) was 3% of issued capital, with 0.3m new Challenger shares issued. Under the terms of the DRP, new Challenger shares were issued based on a 10 day Challenger share price VWAP, with no share price discount applied.

For the interim FY18 dividend, the DRP had the effect of reducing the effective cash dividend payout by approximately 2%.

For the final FY18 dividend, new Challenger shares will be issued in order to fulfil DRP requirements, and will be issued based on a 10 day share price VWAP, with no share price discount applied.

Credit ratings

In November 2017, Standard & Poor's (S&P) completed its ratings review and affirmed both Challenger Life Company Limited's (CLC's) and Challenger Limited's credit ratings and upgraded the outlook for both from stable to positive. The upgraded outlook reflects Challenger's expanded distribution network and leadership in the Australian annuities market, which is expected to strengthen the quality and resilience of underlying operating earnings.

S&P ratings are as follows:

- CLC: 'A' with a positive outlook; and
- Challenger Limited: 'BBB+' with a positive outlook.

FY19 guidance

Normalised net profit before tax

Normalised net profit before tax guidance for FY19 is growth of between 8% and 12%.

FY19 normalised net profit before tax guidance includes Life's reallocation from property to fixed income (refer to page 36 for more detail).

Normalised effective tax rate

The FY19 normalised effective tax rate is expected to be between 26% and 28%.

Normalised Return on Equity (ROE)

Challenger continues to target an 18% pre-tax normalised ROE over the medium term. FY18 normalised ROE was 16.5% (pre-tax) and has been impacted by higher levels of capital following the $500m equity placement to MS&AD in August 2017 (refer to page 28 for more detail).

FY19 normalised ROE (pre-tax) is expected to increase from 16.5% in FY18 but not reach the 18% target.

Life annuity book maturities

Life's annuity book growth is driven by sales and maturities. With Life's focus on long-term annuity sales, maturities are expected to fall from ~25% of opening liabilities in FY18 to ~23% in FY19.

Normalised cost to income ratio

Challenger's business is highly efficient and very scalable. As a result, Challenger is one of Australia's most efficient financial services companies.

Reflecting confidence in continuing to extract scale benefits and operating efficiencies across the Challenger Group, Challenger's normalised cost to income ratio guidance was reduced at the beginning of FY18 to a range of 30% to 34% (from 32% to 36%).

The normalised cost to income ratio was 32.7% in FY18.

Dividend policy

Challenger targets a dividend payout ratio in the range of 45% to 50% of normalised profit after tax and aims to frank dividends to the maximum extent possible. Based on current forecasts, the Board expects future dividends to be fully franked over the medium term.

However, the actual dividend payout ratio and franking levels will depend on prevailing market conditions and capital allocation priorities.

Group balance sheet[1]

$m	FY18	1H18	FY17	1H17	FY16	1H16
Assets						
Life investment assets						
Fixed income and cash (net)	11,727.8	11,076.5	10,415.0	9,520.9	9,315.5	8,487.6
Property (net)	3,840.5	3,654.6	3,407.8	3,328.3	3,150.0	3,063.2
Equity and other investments	1,799.1	1,642.7	1,360.1	1,231.6	1,079.0	1,060.0
Infrastructure (net)	717.7	666.3	494.4	526.4	567.2	536.4
Life investment assets	**18,085.1**	**17,040.1**	**15,677.3**	**14,607.2**	**14,111.7**	**13,147.2**
Cash and cash equivalents (Group cash)	84.9	121.9	83.8	80.7	84.2	89.3
Receivables	198.3	155.1	135.1	121.0	120.2	148.5
Derivative assets	150.7	243.4	232.7	226.0	354.2	292.6
Investment in associates	62.4	54.2	53.5	49.1	51.5	30.2
Other assets	50.6	53.3	46.0	48.2	48.0	50.7
Fixed assets	31.2	32.2	33.7	32.9	34.9	34.3
Goodwill and intangibles	592.9	591.3	588.4	588.4	583.9	585.5
Less Group/Life eliminations[2]	(73.7)	(83.8)	(94.9)	(93.2)	(105.3)	(123.0)
Total assets	**19,182.4**	**18,207.7**	**16,755.6**	**15,660.3**	**15,283.3**	**14,255.3**
Liabilities						
Payables	303.8	249.1	245.5	219.8	228.6	184.9
Tax liabilities	89.0	95.2	199.0	177.7	162.6	182.4
Derivative liabilities	229.6	158.7	216.5	322.7	409.5	352.8
Subordinated debt	403.7	405.3	393.6	384.8	576.7	576.5
Challenger Capital Notes	793.0	791.2	789.4	339.3	338.5	337.7
Provisions	14.6	13.6	13.5	17.4	12.5	21.3
Life annuity book	11,728.3	11,115.8	10,322.2	9,784.9	9,558.5	8,868.4
GIR[3] and Challenger Index Plus Fund liabilities	2,135.0	1,909.3	1,687.8	1,633.2	1,315.5	1,035.1
Total liabilities	**15,697.0**	**14,738.2**	**13,867.5**	**12,879.8**	**12,602.4**	**11,559.1**
Group net assets	**3,485.4**	**3,469.5**	**2,888.1**	**2,780.5**	**2,680.9**	**2,696.2**
Equity						
Contributed equity	2,051.7	2,071.0	1,554.5	1,560.1	1,546.7	1,576.8
Reserves	(33.3)	(47.5)	(16.5)	(29.9)	(7.9)	(19.7)
Retained earnings	1,467.0	1,446.0	1,350.1	1,250.3	1,142.1	1,139.1
Total equity	**3,485.4**	**3,469.5**	**2,888.1**	**2,780.5**	**2,680.9**	**2,696.2**

[1] Excludes consolidation of Special Purpose Vehicles (SPVs) and non-controlling interests.
[2] Group/Life eliminations represent the fair value of the SPV residual income notes (i.e. NIM) held by Challenger Life Company Limited.
[3] Guaranteed Index Return (GIR).

Change in Group net assets

$m	2H18	1H18	2H17	1H17	2H16	1H16
Opening net assets	**3,469.5**	**2,888.1**	**2,780.5**	**2,680.9**	**2,696.2**	**2,543.2**
Statutory net profit after tax	127.1	195.4	196.1	201.5	93.4	234.3
Dividends paid	(106.1)	(99.5)	(96.3)	(93.3)	(90.4)	(87.5)
New share issue	3.3	503.3	3.9	4.1	4.9	6.3
Reserve movements	14.2	(31.0)	13.4	(22.0)	11.8	(43.4)
CPP Trust movements	(22.6)	13.2	(9.5)	9.3	(35.0)	43.3
Closing net assets	**3,485.4**	**3,469.5**	**2,888.1**	**2,780.5**	**2,680.9**	**2,696.2**

Issued share capital

Number of shares (m)	FY18	FY17	FY16	2H18	1H18	2H17	1H17	2H16	1H16
Basic share count	601.7	561.9	558.8	601.7	603.3	561.9	562.3	558.8	562.2
CPP[1] Trust treasury shares	9.2	10.1	12.4	9.2	7.3	10.1	9.4	12.4	8.4
Total issued shares	**610.9**	**572.0**	**571.2**	**610.9**	**610.6**	**572.0**	**571.7**	**571.2**	**570.6**
Movement in basic share count									
Opening	561.9	558.8	553.4	603.3	561.9	562.3	558.8	562.2	553.4
CPP[1] Trust deferred share purchase	(4.0)	(2.8)	(4.0)	(2.0)	(2.0)	(0.8)	(2.0)	(4.0)	-
Net treasury shares (acquired)/released	4.9	5.1	7.9	0.1	4.8	0.1	5.0	-	7.9
New share issues	38.9	0.8	1.5	0.3	38.6	0.3	0.5	0.6	0.9
Closing	601.7	561.9	558.8	601.7	603.3	561.9	562.3	558.8	562.2
Movement in CPP Trust treasury shares									
Opening	10.1	12.4	16.3	7.3	10.1	9.4	12.4	8.4	16.3
Shares vested to participants	(5.7)	(6.1)	(9.5)	(0.1)	(5.6)	(0.1)	(6.0)	(0.5)	(9.0)
CPP[1] Trust deferred share purchase	4.0	2.8	4.0	2.0	2.0	0.8	2.0	4.0	-
Shares bought into CPP Trust	0.8	1.0	1.6	-	0.8	-	1.0	0.5	1.1
Closing	9.2	10.1	12.4	9.2	7.3	10.1	9.4	12.4	8.4

Weighted average number of shares (m)	FY18	FY17	FY16	2H18	1H18	2H17	1H17	2H16	1H16
Basic EPS shares									
Total issued shares	605.2	571.7	570.5	610.9	599.4	571.9	571.4	570.9	570.1
Less CPP[1] Trust treasury shares	(8.5)	(9.5)	(10.3)	(8.7)	(8.3)	(9.8)	(9.1)	(9.7)	(11.0)
Shares for basic EPS calculation	596.7	562.2	560.2	602.2	591.1	562.1	562.3	561.2	559.1
Diluted EPS shares									
Shares for basic EPS calculation	596.7	562.2	560.2	602.2	591.1	562.1	562.3	561.2	559.1
Add diluted impact unvested equity awards	10.7	14.4	16.8	10.5	11.9	14.1	14.7	15.7	17.7
Add dilutive impact of capital notes	65.6	34.8	39.1	65.6	57.8	43.2	31.8	39.1	41.6
Add dilutive impact of subordinated notes	19.6	-	-	32.6	5.9	-	-	-	-
Shares for dilutive EPS calculation	692.6	611.4	616.1	710.9	666.7	619.4	608.8	616.0	618.4

Summary of shares rights (m)	FY18	FY17	FY16	2H18	1H18	2H17	1H17	2H16	1H16
Hurdled Performance Share Rights									
Opening	10.2	12.5	17.3	8.2	10.2	10.4	12.5	13.0	17.3
New grants	2.0	2.5	3.4	-	2.0	-	2.5	-	3.4
Vesting/forfeiture	(4.0)	(4.8)	(8.2)	-	(4.0)	(0.2)	(4.6)	(0.5)	(7.7)
Closing	8.2	10.2	12.5	8.2	8.2	10.2	10.4	12.5	13.0
Deferred Performance Share Rights									
Opening	3.7	3.8	3.5	2.9	3.7	3.7	3.8	3.8	3.5
New grants	1.3	1.6	2.3	-	1.3	-	1.6	-	2.3
Vesting/forfeiture	(2.2)	(1.7)	(2.0)	(0.1)	(2.1)	-	(1.7)	-	(2.0)
Closing	2.8	3.7	3.8	2.8	2.9	3.7	3.7	3.8	3.8

[1] The Challenger Performance Plan (CPP) Trust.

Issued share capital

Issued share capital and diluted share count

The number of Challenger Limited shares listed on the Australian Securities Exchange (ASX) at 30 June 2018 was 611m shares, and increased by 39m in FY18 as a result of:

- 38.3m new shares issued following the equity placement to MS&AD in August 2017 (refer below for more detail); and
- 0.6m new shares issued under Challenger's Dividend Reinvestment Plan (DRP) in September 2017 and March 2018.

In order to broaden Challenger's relationship with MS&AD (refer to page 28 for more detail) and to fund future growth, Challenger completed a $500m equity placement to MS&AD in August 2017. Challenger issued 38.3m new ordinary shares to MS&AD at a price of $13.06 per share, which represented a 2% premium to the 30 business day volume weighted average share price adjusted for the FY17 final dividend.

The equity placement to MS&AD represented 6.3% of Challenger's issued capital with MS&AD subsequently increasing their holding to ~10% of issued capital via on market acquisitions.

The basic share count used to determine Challenger's normalised and statutory EPS is based on requirements set out in Australian Accounting Standards.

Under Australian Accounting Standards:

- the basic share count is reduced for treasury shares;
- the dilutive share count includes unvested equity awards made to employees under the Challenger Performance Plan (CPP); and
- the dilutive share count considers convertible instruments (e.g. Challenger Capital Notes, Challenger Capital Notes 2, and subordinated debt) as determined by a probability of vesting test (refer to page 18 for more detail on the accounting treatment).

Treasury shares

The CPP Trust was established to purchase shares to satisfy Challenger's employee equity obligations arising from hurdled and non-hurdled equity awards issued under employee remuneration structures.

Shares are acquired by the CPP Trust to mitigate shareholder dilution and provide a mechanism to hedge the cash cost of acquiring shares in the future to satisfy vested equity awards.

The CPP Trust typically acquires physical shares on market or via forward share purchase agreements. The use of forward share purchase agreements was implemented to increase capital efficiency. Shares held by the CPP Trust and share forward purchase agreements are classified as treasury shares.

It is expected that should equity awards vest in the future, the CPP Trust will satisfy equity requirements via a combination of treasury shares and settlement of forward purchase agreements. As such, it is not anticipated that new Challenger shares will be issued to meet future vesting obligations of equity awards.

Weighted average number of shares

The weighted average number of shares used to determine both the normalised and statutory basic EPS increased by 35m shares to 597m shares. The increase reflects the time weighted impact of the 38.3m shares issued to MS&AD on 23 August 2017 and 0.6m of new shares issued to support Challenger's DRP, and the net release of treasury shares in order to meet CPP Trust requirements.

The weighted average number of shares used to determine both the normalised and statutory diluted EPS increased by 81m shares in FY18 to 693m shares. The increase reflects the higher weighted average basic share count (up 35m), the dilutive impact of Capital Notes (31m shares – refer to page 18 for more detail), and the dilutive impact of the subordinated debt issued in November 2017 (20m shares – refer to page 18 for more detail).

Unvested equity awards

Hurdled Performance Share Rights (HPSRs)

Challenger's approach to executive remuneration includes providing HPSRs awards to ensure alignment between key employees and shareholders.

HPSRs vest over a period of up to five years with vesting subject to meeting total shareholder return performance hurdles and continued employment.

Deferred Performance Share Rights (DPSRs)

A portion of variable remuneration is awarded in DPSRs which vest over a period of up to three years, subject to continued employment.

Capital Notes

Challenger Life is growing strongly and over the past four years Challenger Limited has issued two separate subordinated, unsecured convertible notes (Challenger Capital Notes and Challenger Capital Notes 2), with proceeds used to fund Challenger Life Company Limited (CLC) qualifying Additional Tier 1 regulatory capital.

Challenger Capital Notes (ASX code 'CGFPA')

In October 2014, Challenger issued Challenger Capital Notes to the value of $345m, which are subordinated, unsecured convertible notes issued by Challenger Limited. Challenger Capital Notes pay a margin of 3.40% above the 90 day Bank Bill rate, with the total distribution reduced by available franking credits.

Challenger Capital Notes are convertible to ordinary shares at any time before May 2022 on the occurrence of certain events, and mandatorily convertible to ordinary shares thereafter, in both cases subject to meeting certain conditions.

However, Challenger retains the option to redeem or resell Challenger Capital Notes and has an outright option to redeem or resell on 25 May 2020 (both subject to certain conditions being met). If Challenger exercises its option to redeem or resell, there will be no conversion of Challenger Capital Notes to Challenger ordinary shares and no subsequent shareholder dilution.

Challenger Capital Notes 2 (ASX code 'CGFPB')

In April 2017, Challenger issued Challenger Capital Notes 2, to the value of $460m, which are subordinated, unsecured convertible notes issued by Challenger Limited. Challenger Capital Notes 2 pay a margin of 4.40% above the 90 day Bank Bill rate with the total distribution reduced by available franking credits.

Challenger Capital Notes 2 are convertible to ordinary shares at any time before May 2025 on the occurrence of certain events, and mandatorily convertible to ordinary shares thereafter, in both cases subject to meeting certain conditions.

However, Challenger retains the option to redeem or resell Challenger Capital Notes 2 on 22 May 2023 (both subject to certain conditions being met). If Challenger exercises its option to redeem or resell, there will be no conversion of Challenger Capital Notes 2 to Challenger ordinary shares and no subsequent shareholder dilution.

Subordinated debt

In November 2017, CLC issued $400m of Tier 2 subordinated notes. The subordinated notes qualify as Tier 2 regulatory capital under APRA's prudential standards and are floating rate notes, paying interest at a margin of 2.10% above the 90 day Bank Bill rate.

The subordinated notes mature in November 2042 with CLC having the option to redeem the notes in November 2022, subject to APRA approval.

The subordinated notes qualify 100% as Tier 2 regulatory capital until November 2038.

Proceeds from the subordinated notes were used to repay CLC's existing Tier 2 subordinated debt instrument that had a call date in November 2017.

The replacement of the subordinated debt is not expected to have a material impact on Life's interest expense, which is included in Life’s cash operating earnings.

The subordinated notes include a holder conversion option, allowing the note holder to convert the notes into Challenger ordinary shares in November 2024 if CLC has not already called the subordinated notes in November 2022.

If CLC exercises its option to redeem, there will be no conversion of subordinated debt to Challenger ordinary shares and no subsequent shareholder dilution.

Accounting treatment of Capital Notes and subordinated debt

Challenger Capital Notes, Challenger Capital Notes 2 and subordinated debt are an effective source of funding for Challenger.

Under Australian Accounting Standards, convertible debt is considered dilutive whenever the interest per ordinary share is less than the basic earnings per share. As such, a test is required to be undertaken each reporting period to determine if they are included in the dilutive share count.

Under Australian Accounting Standards, Challenger Capital Notes, Challenger Capital Notes 2 and subordinated debt have been considered to be dilutive at 30 June 2018 and have been included in Challenger's FY18 dilutive share count. The FY18 dilutive share count includes 20m shares in respect of subordinated debt issued in November 2017, being the time weighted impact of the subordinated notes.

If Challenger exercises its option to redeem Challenger Capital Notes, Challenger Capital Notes 2 or the subordinated notes, there will be no conversion to Challenger ordinary shares and no subsequent shareholder dilution.

Consolidated operating cash flow

$m	FY18	FY17	FY16	2H18	1H18	2H17	1H17	2H16	1H16
Receipts from customers	670.2	673.0	598.4	333.7	336.5	334.0	339.0	317.2	281.2
Dividends received	94.8	66.5	56.4	41.0	53.8	30.5	36.0	24.2	32.2
Interest received	750.1	673.7	639.1	364.5	385.6	347.2	326.5	294.3	344.8
Interest paid	(571.9)	(527.1)	(444.8)	(296.9)	(275.0)	(293.6)	(233.5)	(221.0)	(223.8)
Payments to suppliers and employees	(548.3)	(508.1)	(488.1)	(253.6)	(294.7)	(246.6)	(261.5)	(231.6)	(256.5)
Income tax paid	(197.5)	(78.1)	(63.9)	(45.1)	(152.4)	(40.1)	(38.0)	(33.4)	(30.5)
Underlying operating cash flow	**197.4**	**299.9**	**297.1**	**143.6**	**53.8**	**131.4**	**168.5**	**149.7**	**147.4**
Adjusted for:									
Net annuity policy capital receipts	1,392.7	900.4	740.4	634.5	758.2	451.5	448.9	469.9	270.5
Net other Life capital receipts/(payments)	403.6	412.5	309.0	214.0	189.6	67.5	345.0	230.1	78.9
Other[1]	(16.3)	(15.6)	(64.1)	18.6	(34.9)	6.9	(22.5)	(34.9)	(29.2)
Operating cash flow per financial report	**1,977.4**	**1,597.2**	**1,282.4**	**1,010.7**	**966.7**	**657.3**	**939.9**	**814.8**	**467.6**

[1] Other includes net SPV operating cash flow adjustments for differences between statutory operating cash flow and normalised cash operating earnings.

Underlying operating cash flow excludes cash flows that are capital in nature such as annuity sales and annuity capital payments.

FY18 underlying operating cash flow was $197m, down $103m on FY17. The reduction in underlying operating cash flow reflects an increase in income tax paid, up $119m on FY17. The FY18 income tax paid includes tax payments in relation to FY17 tax liabilities and increased Pay As You Go instalments in respect of FY18.

Net annuity policy capital receipts

FY18 net annuity policy capital receipts were $1,393m and comprise:

- annuity sales of $4,001m; less
- annuity capital payments of $2,608m.

Annuity capital payments represent the return of capital to annuitants and exclude interest payments.

FY18 annuity net flows were $1.4bn and increased by 55% on FY17. Annuity net book growth was 13.5% (FY17 9.4%) and can be calculated as annuity net flows ($1,393m) divided by opening period Life annuity book ($10,322m – refer to page 21).

Net other Life capital receipts

FY18 net other Life capital receipts were $404m and comprise:

- other Life sales of $1,555m; less
- other Life capital payments of $1,151m.

FY18 Other Life sales include existing Guaranteed Index Return (GIR) mandate rollovers of $1.0bn, new GIR client mandates of $0.4bn, and Challenger Index Plus Fund sales of $0.2bn.

Challenger Index Plus Fund is a pooled version of GIR with liquidity and backed by high grade liquid fixed income. Challenger Index Plus Fund was launched in October 2017 and targets a return of cash plus 3%.

FY18 other Life net flows were $404m and were broadly in line with FY17. FY18 total Life book growth was 15.0% (FY17 12.1%) and can be calculated as total net flows ($1,796m) divided by the sum of the opening period liabilities of $12,010m (Life annuity book, GIR and Challenger Index Plus Fund – refer to page 21).

Life financial results

$m	FY18	FY17	FY16	2H18	1H18	2H17	1H17	2H16	1H16
Investment yield – policyholders' funds	869.0	813.5	767.5	433.6	435.4	408.5	405.0	385.1	382.4
Interest expense	(485.4)	(426.7)	(410.4)	(250.7)	(234.7)	(216.4)	(210.3)	(203.5)	(206.9)
Distribution expense	(22.1)	(27.8)	(24.5)	(10.4)	(11.7)	(11.3)	(16.5)	(14.3)	(10.2)
Other income[1]	22.8	36.4	24.4	12.0	10.8	11.9	24.5	12.8	11.6
Product cash margin	**384.3**	**395.4**	**357.0**	**184.5**	**199.8**	**192.7**	**202.7**	**180.1**	**176.9**
Investment yield – shareholders' funds	154.8	131.0	134.9	78.2	76.6	68.4	62.6	67.3	67.6
Cash earnings	**539.1**	**526.4**	**491.9**	**262.7**	**276.4**	**261.1**	**265.3**	**247.4**	**244.5**
Normalised capital growth	130.5	105.0	100.5	70.8	59.7	53.9	51.1	52.1	48.4
Normalised Cash Operating Earnings	**669.6**	**631.4**	**592.4**	**333.5**	**336.1**	**315.0**	**316.4**	**299.5**	**292.9**
Personnel expenses	(67.7)	(61.8)	(56.7)	(33.9)	(33.8)	(31.7)	(30.1)	(29.8)	(26.9)
Other expenses	(39.2)	(38.4)	(35.9)	(19.9)	(19.3)	(19.1)	(19.3)	(18.8)	(17.1)
Total expenses	**(106.9)**	**(100.2)**	**(92.6)**	**(53.8)**	**(53.1)**	**(50.8)**	**(49.4)**	**(48.6)**	**(44.0)**
Normalised EBIT	**562.7**	**531.2**	**499.8**	**279.7**	**283.0**	**264.2**	**267.0**	**250.9**	**248.9**
Asset and liability experience[2]	(45.0)	78.8	(25.9)	(60.5)	15.5	34.9	43.9	(65.5)	39.6
New business strain[2]	(58.9)	(57.4)	(42.5)	(21.5)	(37.4)	(22.0)	(35.4)	(45.9)	3.4
Total investment experience	**(103.9)**	**21.4**	**(68.4)**	**(82.0)**	**(21.9)**	**12.9**	**8.5**	**(111.4)**	**43.0**
Net profit after investment experience before tax	**458.8**	**552.6**	**431.4**	**197.7**	**261.1**	**277.1**	**275.5**	**139.5**	**291.9**
Reconciliation of investment experience to capital growth									
Asset and liability experience	(45.0)	78.8	(25.9)	(60.5)	15.5	34.9	43.9	(65.5)	39.6
Normalised capital growth	130.5	105.0	100.5	70.8	59.7	53.9	51.1	52.1	48.4
Asset and liability capital growth	**85.5**	**183.8**	**74.6**	**10.3**	**75.2**	**88.8**	**95.0**	**(13.4)**	**88.0**
Performance analysis									
Cost to income ratio[3]	16.0%	15.9%	15.6%	16.1%	15.8%	16.1%	15.6%	16.2%	15.0%
Net assets – average[4]	3,034	2,525	2,456	3,127	2,959	2,586	2,468	2,487	2,441
Normalised ROE (pre-tax)	18.5%	21.0%	20.4%	18.0%	19.0%	20.6%	21.5%	20.3%	20.3%

[1] Other income includes Accurium revenue and Life Risk revenue (premiums net of claims).
[2] Investment experience comprises asset and liability experience and net new business strain. Refer to page 54 for more detail.
[3] Cost to income ratio calculated as total expenses divided by Normalised Cash Operating Earnings.
[4] Net assets – average calculated on a monthly basis.

Life financial results

$m	FY18	FY17	FY16	2H18	1H18	2H17	1H17	2H16	1H16
Sales									
Fixed term sales	3,145.8	3,024.3	2,769.8	1,278.6	1,867.2	1,382.4	1,641.9	1,357.4	1,412.4
Lifetime sales	854.9	986.9	581.4	432.6	422.3	432.7	554.2	352.7	228.7
Life annuity sales	**4,000.7**	**4,011.2**	**3,351.2**	**1,711.2**	**2,289.5**	**1,815.1**	**2,196.1**	**1,710.1**	**1,641.1**
Maturities and repayments	(2,608.0)	(3,110.8)	(2,610.8)	(1,076.7)	(1,531.3)	(1,363.6)	(1,747.2)	(1,240.2)	(1,370.6)
Life annuity flows	**1,392.7**	**900.4**	**740.4**	**634.5**	**758.2**	**451.5**	**448.9**	**469.9**	**270.5**
Closing Life annuity book	11,728.3	10,322.2	9,558.5	11,728.3	11,115.8	10,322.2	9,784.9	9,558.5	8,868.4
Annuity book growth[1]	**13.5%**	**9.4%**	**8.5%**	**6.2%**	**7.3%**	**4.7%**	**4.7%**	**5.4%**	**3.1%**
Other Life sales	1,554.9	941.2	998.5	520.4	1,034.5	378.9	562.3	588.8	409.7
Other maturities and repayments	(1,151.3)	(528.7)	(670.6)	(306.5)	(844.8)	(360.9)	(167.8)	(337.5)	(333.1)
Other Life flows	**403.6**	**412.5**	**327.9**	**213.9**	**189.7**	**18.0**	**394.5**	**251.3**	**76.6**
Closing GIR[2] and Challenger Index Plus Fund liabilities	2,135.0	1,687.8	1,315.5	2,135.0	1,909.3	1,687.8	1,633.2	1,315.5	1,035.1
Other Life net book growth[1]	**23.9%**	**31.4%**	**34.7%**	**12.7%**	**11.2%**	**1.4%**	**30.0%**	**26.6%**	**8.1%**
Total Life sales	5,555.6	4,952.4	4,349.7	2,231.6	3,324.0	2,194.0	2,758.4	2,298.9	2,050.8
Total maturities and repayments	(3,759.3)	(3,639.5)	(3,281.4)	(1,383.2)	(2,376.1)	(1,724.5)	(1,915.0)	(1,577.7)	(1,703.7)
Total Life net flows	**1,796.3**	**1,312.9**	**1,068.3**	**848.4**	**947.9**	**469.5**	**843.4**	**721.2**	**347.1**
Closing total Life book[3]	13,863.3	12,010.0	10,874.0	13,863.3	13,025.1	12,010.0	11,418.1	10,874.0	9,903.5
Total Life book growth[1]	**15.0%**	**12.1%**	**11.1%**	**7.1%**	**7.9%**	**4.3%**	**7.8%**	**7.5%**	**3.6%**
Assets									
Closing investment assets	**18,085**	**15,677**	**14,112**	**18,085**	**17,040**	**15,677**	**14,607**	**14,112**	**13,147**
Fixed income and cash[4]	11,189	9,746	8,473	11,380	10,984	10,028	9,434	8,537	8,409
Property	3,543	3,274	3,178	3,714	3,388	3,350	3,205	3,220	3,120
Equity and other investments	1,671	1,183	988	1,807	1,532	1,262	1,110	1,059	928
Infrastructure	620	524	550	681	566	510	538	553	545
Average Investment assets[5]	**17,023**	**14,727**	**13,189**	**17,582**	**16,470**	**15,150**	**14,287**	**13,369**	**13,002**
Liabilities									
Closing liabilities	**15,072**	**13,209**	**11,796**	**15,072**	**14,235**	**13,209**	**12,148**	**11,796**	**10,825**
Annuities, GIR[2] and Challenger Index Plus Fund	13,051	11,471	9,981	13,530	12,568	11,802	11,133	10,166	9,786
Capital notes	805	451	345	805	805	542	345	345	345
Subordinated debt	404	481	579	407	401	392	556	574	584
Average liabilities[5]	**14,260**	**12,403**	**10,905**	**14,742**	**13,774**	**12,736**	**12,034**	**11,085**	**10,715**
Margins[6]									
Investment yield – policyholders' funds	5.11%	5.52%	5.82%	4.97%	5.25%	5.44%	5.62%	5.80%	5.84%
Interest expense	(2.85%)	(2.90%)	(3.11%)	(2.87%)	(2.83%)	(2.88%)	(2.92%)	(3.06%)	(3.16%)
Distribution expense	(0.13%)	(0.19%)	(0.19%)	(0.12%)	(0.14%)	(0.16%)	(0.23%)	(0.22%)	(0.16%)
Other income	0.13%	0.25%	0.19%	0.14%	0.13%	0.16%	0.34%	0.19%	0.18%
Product cash margin	**2.26%**	**2.68%**	**2.71%**	**2.12%**	**2.41%**	**2.56%**	**2.81%**	**2.71%**	**2.70%**
Investment yield – shareholders' funds	0.91%	0.89%	1.02%	0.89%	0.92%	0.92%	0.87%	1.01%	1.03%
Cash earnings	**3.17%**	**3.57%**	**3.73%**	**3.01%**	**3.33%**	**3.48%**	**3.68%**	**3.72%**	**3.73%**
Normalised capital growth	0.76%	0.72%	0.76%	0.82%	0.72%	0.71%	0.71%	0.79%	0.74%
Normalised Cash Operating Earnings (COE)	**3.93%**	**4.29%**	**4.49%**	**3.83%**	**4.05%**	**4.19%**	**4.39%**	**4.51%**	**4.47%**

[1] 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.
[2] Guaranteed Index Return (GIR).
[3] Life annuity book, GIR and Challenger Index Plus Fund liabilities.
[4] Includes average NIM (FY18: $83m, FY17: $94m, FY16: $120m).
[5] Average investment assets and average liabilities calculated on a monthly basis.
[6] Ratio of Normalised Cash Operating Earnings components divided by average investment assets.

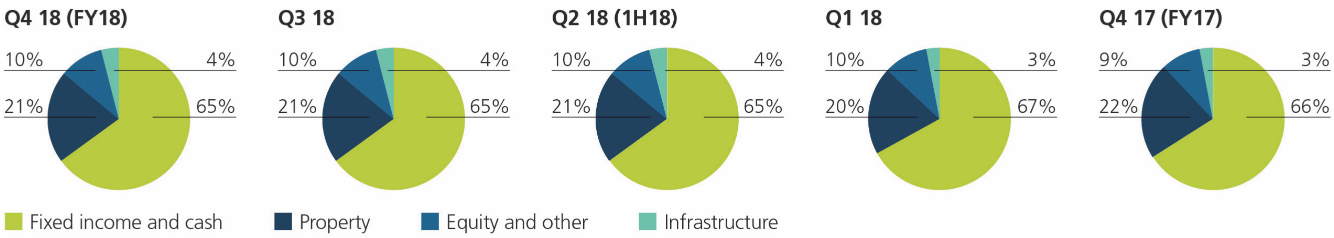
Life financial results

Life quarterly sales and investment assets

$m	Q4 18	Q3 18	Q2 18	Q1 18	Q4 17
Life sales					
Fixed term sales	735	544	980	887	720
Lifetime sales[1]	216	217	212	210	215
Life annuity sales	**951**	**761**	**1,192**	**1,097**	**935**
Maturities and repayments	(632)	(445)	(786)	(745)	(828)
Life annuity flows	**319**	**316**	**406**	**352**	**107**
Annuity book growth[2]	**3.1%**	**3.1%**	**3.9%**	**3.4%**	**1.1%**
Other Life sales	182	338	562	473	1
Other maturities and repayments	(281)	(25)	(543)	(302)	-
Other Life flows	**(99)**	**313**	**19**	**171**	**1**
Other Life net book growth[2]	**(5.8%)**	**18.5%**	**1.1%**	**10.1%**	**0.1%**
Total Life sales	1,133	1,099	1,754	1,570	936
Total maturities and repayments	(913)	(470)	(1,329)	(1,047)	(828)
Total Life net flows	**220**	**629**	**425**	**523**	**108**
Total Life book growth[2]	**1.9%**	**5.2%**	**3.5%**	**4.4%**	**1.0%**
Life					
Fixed income and cash[3]	11,728	11,413	11,076	11,096	10,415
Property[3]	3,840	3,718	3,655	3,305	3,408
Equity and other	1,799	1,868	1,643	1,594	1,360
Infrastructure[3]	718	673	666	491	494
Total Life investment assets	**18,085**	**17,672**	**17,040**	**16,486**	**15,677**
Average Life investment assets[4]	**17,824**	**17,362**	**16,884**	**16,059**	**15,559**

[1] Lifetime sales includes CarePlus, a lifetime annuity specifically designed for the aged care market.
[2] Book growth percentage represents net flows for the period divided by opening book value for the financial year.
[3] Fixed income, property and infrastructure reported net of debt.
[4] Average Life investment assets calculated on a monthly basis.

Life asset allocation



Life financial results

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

As Australia's largest annuity provider, Challenger Life Company Limited (CLC) provides reliable guaranteed[1] incomes to 75,000 Australian retirees.

Life's annuity products appeal to retirees because they provide security and certainty of guaranteed income while protecting against risks from market downturns and inflation. Lifetime annuities protect retirees from the risk of outliving their savings by paying guaranteed income for life.

The retirement incomes Life pays are backed by a high-quality investment portfolio, predominantly fixed income and commercial property investments. These investments generate regular and predictable investment income which is used to fund retirement incomes paid to customers.

Life's products are distributed via financial advisers, both independent and within the major hubs. Being an independent product manufacturer, Life's products are included on all major hub Approved Product Lists (APLs) and are available on leading investment and administration platforms.

Life is the market leader in Australian retirement incomes, with a 73%[2] annuity market share and has won the Association of Financial Advisers Annuity Provider of the Year for the last 10 consecutive years.

Life also has an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of Australian dollar denominated annuities in Japan (refer to page 28 for more detail).

The Life business includes Accurium, one of Australia's leading providers of Self-Managed Superannuation Fund (SMSF) actuarial certificates and participates in wholesale reinsurance longevity and mortality transactions (refer to page 24 for more detail).

CLC is an APRA regulated entity and its financial strength is rated by Standard & Poor's with an 'A' rating and positive outlook. CLC capital strength is outlined on pages 42 and 43.

Normalised EBIT and ROE

Life normalised EBIT was $563m in FY18 and increased by $31m (6%) on FY17. The increase in EBIT reflects a $38m increase in normalised Cash Operating Earnings (COE), partly offset by a $7m increase in expenses.

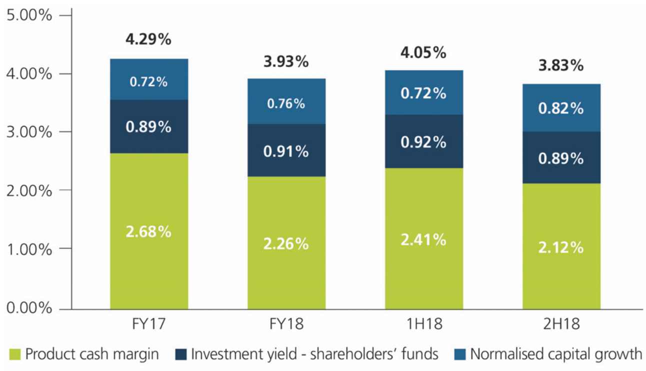
Life normalised ROE (pre-tax) was 18.5% in FY18 and decreased by 250 bps from 21.0% in FY17. Life normalised ROE was temporarily impacted by higher levels of capital following the MS&AD equity placement in August 2017 (refer to page 28 for more details).

Normalised Cash Operating Earnings (COE) and COE margin

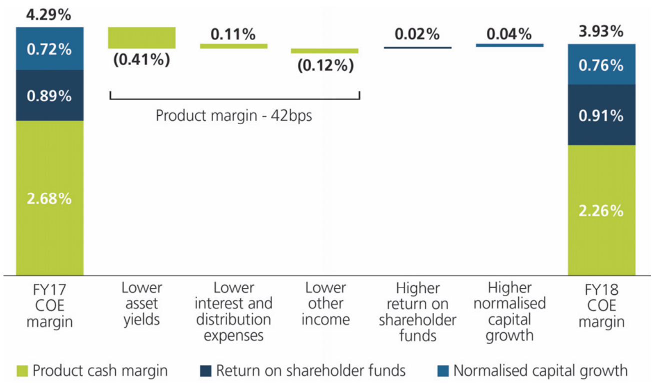
FY18 normalised COE was $670m and increased by $38m (6%) on FY17. Excluding the ~$10m one-off Life Risk fee received in FY17, normalised COE increased by 8%.

The increase in normalised COE is a result of higher average investment assets (up 16%), partially offset by a reduction in Life's COE margin. Life's COE margin was impacted by a change in product mix, lower other income, lower interest rates and compressed asset risk premiums.

Life COE margin composition



FY17 to FY18 COE margin



Life's FY18 COE margin was 3.93%, and was down 36 bps on FY17 (4.29%). The change in COE margin was a result of:

- Lower product cash margin -42 bps. The product cash margin includes lower asset yields of 41 bps and lower other income of 12 bps, partially offset by a 11 bps reduction in interest and distribution expenses.

  Other income was 12 bps lower than FY17 due to a one-off Life Risk fee of approximately $10m in FY17 following a counterparty restructuring a transaction.

  Excluding the reduction in other income (12 bps), the product cash margin fell by 30 bps and was impacted by a change in product mix and lower asset yields.

  The proportion of GIR (GIR mandates and Challenger Index Plus) and Japanese annuity business represented 22% of Life's FY18 average liabilities, up from 15% in FY17.

  GIR mandates and Challenger Index Plus generate a lower COE margin, as they are fully backed by high grade fixed income investments. Challenger Index Plus is a callable version of GIR and is backed entirely by liquid high grade fixed income investments. Reflecting the liquid nature of these investments, Challenger Index Plus generates a lower margin than institutional GIR mandates.

  The Japanese annuity business is highly efficient. The COE margin includes Life's share of distribution costs with limited

[1] The word 'guaranteed' means payments are guaranteed by Challenger Life Company Limited from the assets of its relevant statutory fund.
[2] Strategic Insights – March 2018.

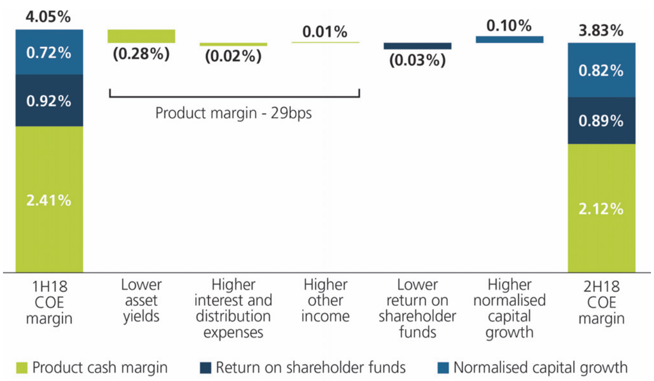
additional distribution and operational costs included in Life's expense base. As a result, the COE margin on the Japanese annuity business is lower than the margin for domestic annuities.

The proportion of higher margin domestic annuities reduced to 78% of Life's FY18 average liabilities, down from 85% in FY17.

- Higher income on shareholder capital +2 bps. The income on shareholder capital increased due to higher average shareholder capital, partially offset by a lower return on shareholder capital.
- Higher normalised capital growth +4 bps. Normalised capital growth increased due to a higher allocation to equities and infrastructure allocation.

FY18 normalised COE includes other income of $23m and includes Accurium revenue of $8m and Life Risk revenue of $15m. Life Risk revenue represents premiums net of expected claims on wholesale reinsurance longevity and mortality transactions (refer below for more detail).

1H18 to 2H18 COE margin



Life's 2H18 COE margin of 3.83% was 22 bps lower than 1H18. The change in COE margin was a result of:

- Lower product cash margin -29 bps. The product margin includes lower asset yields of 28 bps and higher interest and distribution expenses of 2 bps, partially offset by higher other income of 1 bp.

  The 2H18 product cash margin was impacted by lower asset yields, including no distributions in 2H18 on Challenger's insurance linked investments (~$8m) following their write down in 1H18.
- Lower income on shareholder capital -3 bps. The income on shareholder capital fell due to a lower return on shareholder capital more than offsetting the increase in average shareholder capital.
- Higher normalised capital growth +10 bps due to a higher allocation to equities and infrastructure.

Life Risk

Undertaking wholesale longevity and mortality transactions is a natural business extension for the Life business. Life is participating in established markets, has specialised expertise and is taking a disciplined approach to the wholesale Life Risk opportunity.

FY18 Life COE includes $15m of income from Life Risk transactions, representing premiums net of expected claims.

The present value of future profits arising from the Life Risk portfolio was $473m at 30 June 2018, up ~80% from $263m at 30 June 2017.

The increase in the present value of future profits was a result of mortality assumption changes in respect of the UK longevity portfolio. The Life Risk portfolio has an average duration of 15 years.

Accurium

Accurium is one of Australia's leading providers of Self-Managed Superannuation Fund (SMSF) actuarial certificates. An actuarial certificate is required by an SMSF when one (or more) members are in the retirement phase of superannuation and one (or more) are in the savings (accumulation) phase of superannuation. Accurium's FY18 revenue was $8m (FY17 $9m) and is disclosed as part of other income within Life's normalised cash operating earnings framework.

Expenses

FY18 Life expenses were $107m, and increased by $7m (7%) on FY17. Personnel expenses of $68m increased by $6m (10%) due to a higher number of employees and general salary increases. Employee numbers increased in order to support Life's business growth.

Other expenses of $39m increased by $1m on FY17.

Life's FY18 cost to income ratio was 16.0% and was broadly stable on FY17.

Investment experience overview

Challenger Life is required by accounting standards and prudential standards to value all assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on assets and policy liabilities being recognised in the profit and loss, particularly during periods of market volatility. As Challenger is generally a long-term holder of assets, due to them being held to match the term of liabilities, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

Investment experience removes the volatility arising from asset and liability valuation movements so to more accurately reflect the underlying performance of the Life business.

Investment experience includes both assets and policy liability experience and net new business strain.

FY18 investment experience was a loss of $104m (pre-tax), comprising a $45m loss on the fair value of Life's assets and policy liabilities, and a $59m loss in relation to net new business strain.

($m)	Actual capital growth	Normalised capital growth	Investment experience
Fixed income	40	39	79
Property	134	(70)	64
Equity and other	(80)	(75)	(155)
Infrastructure	(34)	(24)	(58)
Policy liability	25	-	25
Assets and policy liability experience	**85**	**(130)**	**(45)**
New business strain	(59)	-	(59)
Total investment Experience	**26**	**(130)**	**(104)**

Asset and liability experience

Asset and liability experience is calculated as the difference between actual investment gains/losses (both realised and unrealised) and normalised capital growth in relation to assets, plus any economic and actuarial assumption changes in relation to policy liabilities for the period.

Asset and liability experience includes the impact of changes in macroeconomic variables on the valuation of Life's assets and liabilities and assumption changes to bond yields and inflation factors, expense assumptions, and other factors applied in the valuation of life contract liabilities.

Asset and liability experience was $45m in FY18, comprising:

- a gain on Life's fixed income portfolio (+$79m) – reflecting a ~20 bps contraction in credit spreads on the portfolio. As Challenger is generally a hold to maturity investor, any unrealised revaluations on Challenger's fixed income portfolio are expected to reverse over time. The credit default experience recognised in the profit and loss in FY18 was -$7m or -6 bps;
- property valuation gains (+$64m) – reflecting a 4% increase in Life's direct property portfolio in FY18, exceeding Life's 2% per annum normalised growth assumption. Property valuation gains in FY18 were supported by the renewal of a number of long-term leases and cap rates tightening in some market segments;
- losses on Life's equity portfolio (-$155m) – reflecting equities underperforming Challenger's normalised growth assumption of 4.5% per annum. Equity valuations were impacted by losses on insurance linked investments of $33m in 1H18 and underperformance of market neutral and alternative strategies;
- losses on infrastructure (-$58m) – reflecting infrastructure underperforming Challenger's normalised growth assumption of 4% per annum. Infrastructure valuations were impacted by the redevelopment of an offshore asset, the timing of distributions and unrealised valuation losses on infrastructure assets; and
- gains on policy liability (+$25m) – reflecting changes in economic and actuarial assumptions, including changes to bond yields, expected inflation rates, and expense assumptions on policy liabilities. The FY18 gain relates to lapse, expense and other assumptions changes (+$40m), partially offset by a $15m illiquidity premium loss (refer below).

Illiquidity premium

In accordance with Prudential Standards and Australian Accounting Standards, Challenger Life values term annuities at fair value and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Commonwealth Government bond curve plus an illiquidity premium.

Movements in credit spreads impact the fair value of assets as well as the illiquidity premium which forms part of the discount rate used to value policy liabilities.

The illiquidity premium used to value policy liabilities is calculated in accordance with AASB 1038 Life Insurance Contracts and AASB 139 Financial Instruments: Recognition and Measurement.

In FY18, corporate bond spreads to Australian Commonwealth Government securities contracted by approximately 10 bps, which lowered the liability discount rate used to fair value annuity liabilities and resulted in a higher annuity liability. As a result, FY18 investment experience includes a loss of ~$15m due to a change in the illiquidity premium used to value policy liabilities.

New business strain

In accordance with Australian Accounting Standards, Challenger Life values term annuities at fair value and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Commonwealth Government bond curve plus an illiquidity premium.

Life tends to offer annuity rates which are higher than these rates. As a result, on writing new annuity business, a loss is recognised when issuing the annuity contract due to a lower discount rate used to value the liability.

New business strain is a non-cash item and subsequently reverses over the future period of the contract. The new business strain reported in the period represents the non-cash loss on new sales net of the reversal of the new business strain of prior period sales. The FY18 net new business strain was a loss of $59m (FY17 $58m).

Life sales and AUM

Total Life sales

Total Life sales were $5.6bn in FY18, and increased by 12% on FY17. FY18 Life sales comprised annuity sales of $4.0bn (unchanged on FY17) and other Life sales of $1.6bn (up 65% on FY17).

Annuity sales

Both Challenger's term and lifetime annuity sales are benefiting from favourable demographic trends, including an ageing population and retiree preferences for secure income streams in retirement. These favourable demographic trends are being leveraged by Challenger's market leading retirement income brand, highly rated distribution team, thought leadership, research and product capability.

Challenger's annuity sales are also benefiting from new distribution relationships, allowing access to Challenger annuities via leading investment and administration platforms.

Commencing in FY16, Challenger began making its annuities available on leading wealth manager administration and investment platforms, allowing superannuation funds and platforms to easily and efficiently combine lifetime income streams with other retirement products to provide income for life, a requirement of CIPRs and the Government's Retirement Income Framework (refer to page 29 for more detail).

During FY16, Challenger annuities were made available by Colonial First State and VicSuper, to create Australia's first CIPR. In FY17, Challenger annuities were made available on the ClearView Wealth Solutions platform and made available to three profit-for-member superannuation funds (CareSuper, legalsuper, Local Government Super) and Suncorp commenced selling Suncorp branded annuities backed by Challenger.

In September 2017 Challenger annuities were launched on AMP's investment and administration platforms and made available to AMP's retail and corporate superannuation customers.

In 1H19, Challenger is making its annuities available on the new BT Panorama platform with the launch targeted for the September 2018 quarter.

These new platform and distribution initiatives are significantly broadening access to Challenger annuities and making annuities more easily accessible by superannuation funds, financial advisers and their clients.

Once Challenger annuities are launched on the BT platform, platform relationships will provide two thirds of Australian financial advisers with access to Challenger annuities via an investment and administration platform.

Following the Government announcing a Retirement Income Framework (refer to page 29 for more detail), there has been a significant increase in superannuation funds and investment and administration platforms considering making Challenger annuities available to their members.

In October 2016, Challenger announced an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of Australian dollar annuity and life insurance products in Japan (refer to page 28 for more information). The MS Primary annuity relationship provides access to the Japanese foreign currency annuities market and is helping to diversify Challenger's distribution channels and product offering. The relationship has started strongly and contributed 15% of Life's FY18 total annuity sales.

Term annuity sales

FY18 term annuity sales were $3.1bn and increased by 4% on FY17. Term annuity sales are benefiting from demographic changes, rising superannuation savings and Challenger's expanded distribution and product offering.

Lifetime annuity sales

Lifetime annuity sales were $855m in FY18 and comprised Liquid Lifetime sales of $525m and CarePlus sales of $330m.

Lifetime annuity sales were down 13% on FY17 due to Liquid Lifetime sales being impacted by uncertainty during the Department of Social Services review of the means test rules for lifetime income streams. In May 2018, the Government announced that new rules for lifetime incomes will apply from 1 July 2019, with existing rules continuing until then.

CarePlus is a lifetime annuity specifically designed for the aged care market and was launched in early FY16. CarePlus sales are growing strongly and were $330m in FY18, an increase of 63% on FY17. CarePlus sales are benefiting from an ageing population and advisers having a greater understanding of the CarePlus product and benefits it provides their aged care clients. The number of financial advisers writing CarePlus during FY18 increased by 32%.

Focus on long-term annuity sales

Challenger is focused on growing its long-term annuity business as it embeds significant value for Challenger shareholders. Approximately 36% of FY18 sales were either lifetime annuities or MS Primary annuities, up from only 17% two years ago (FY16).

Lifetime and long-term MS Primary annuities accounted for 43% of total annuities in force at 30 June 2018, up from 20% only five years ago (FY13).

Long-term annuity business is attractive for Challenger as it:

- lengthens the annuity book tenor;
- improves the maturity outlook;
- assists future book growth;
- enhances overall book quality; and
- allows investing in longer term less liquid assets generating an illiquidity premium.

New business tenor

With Challenger's focus on long-term annuities, the tenor of new business sales has been increasing. New business tenor in FY18 was 9.1 years, up from 6.5 years two years ago (FY16).

New business tenor in FY18 (9.1 years) was lower than FY17 (10.8 years) despite long-term sales being relatively constant in both FY17 and FY18 at approximately 40% of total annuity sales. This was due to a change in mix of lifetime sales, with a higher proportion of CarePlus sales and lower proportion of Liquid Lifetime sales.

Other Life sales

Other Life sales represent Challenger's institutional Guaranteed Index Return (GIR) product and the recently launched Challenger Index Plus Fund, which is a liquid GIR product backed by high grade liquid fixed income. Both GIR and the Challenger Index Plus Fund target Australian superannuation funds.

FY18 other Life sales were $1.6bn and included existing GIR client mandate rollovers ($1.0bn), new GIR mandates ($0.4bn), and Challenger Index Plus Fund ($0.2bn) sales.

Life book liability maturity profile

Long-term annuity business is attractive for Challenger as it improves the maturity outlook and enhances overall net book growth. In FY18, the benefit of focusing on long-term annuities started to be realised with $2.6bn of annuity maturities, which was down $0.5bn on FY17 despite the annuity book being 14% larger.

The annuity maturity rate, which represents annuity maturities and repayments (excluding interest payments) divided by the opening period annuity liability, was 25% in FY18, down from 33% in FY17.

The annuity maturity rate is expected to reduce further in FY19, falling to approximately 23% of the opening period liability.

Net book growth

Life annuity book growth

FY18 Life annuity net flows (i.e. annuity sales less capital repayments) were $1.4bn and increased by 55% on FY17.

Based on the opening Life annuity book liability ($10,322m), FY18 annuity book growth was 13.5% (FY17 9.4%).

Other Life book growth

FY18 other Life net flows (i.e. other Life sales less capital repayments) were $0.4bn, unchanged from FY17.

Total Life book growth

FY18 total Life net flows across both annuities and other products (GIR and Challenger Index Plus Fund) were $1.8bn, 37% higher than FY17, and include annuity net flows of $1.4bn and other net flows of $0.4bn.

Based on the opening FY18 annuity liability ($10,322m) and GIR and Challenger Index Plus Fund liability ($1,688m), FY18 total Life book growth was 15.0%, up from 12.1% in FY17.

Average AUM

Life's average investment assets were $17.0bn in FY18 and increased by 16% (or $2.3bn) on FY17. The increase in average investment assets was primarily due to annuity net flows ($1.4bn), net flows on other products ($0.4bn) and proceeds from the MS&AD equity placement ($0.5bn).

Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary) annuity relationship

Consistent with Challenger's strategy to diversify its range of products and expand its distribution relationships, in November 2016 Challenger commenced a new annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary).

MS Primary provides annuity and life insurance products to Japanese customers and is part of MS&AD Insurance Group Holdings Inc., a Nikkei 225 company.

Japan has one of the world's most rapidly ageing populations who are looking for income from longer dated products due to the low Japanese interest rate environment. This has driven a significant increase in demand for foreign currency annuities, including Australian dollar denominated annuities.

In late August 2016, MS Primary launched an innovative Australian dollar product with a 20-year fixed rate in Japan. The product is being distributed through the Japanese bancassurance channel.

In relation to reinsuring this product, from 1 November 2016 Challenger commenced issuing Australian dollar fixed rate annuities with a 20-year term in order to support the reinsurance agreement with MS Primary. Challenger provides a guaranteed interest rate and assumes the investment risk on a portion of each new policy issued by MS Primary.

During FY18, Challenger and MS Primary have developed a new Australian dollar lifetime annuity product for the Japanese market.

For FY19 Challenger will reinsure the initial Australian dollar 20-year fixed term annuity product and the new Australian dollar lifetime annuity.

The MS Primary annuity portfolio is invested in broadly similar key asset classes that Challenger currently invests in and is accounted for under Australian Generally Accepted Accounting Principles and Challenger's normalised profit framework, consistent with Challenger's Life business.

MS Primary is responsible for marketing and providing the products in Japan, including making payments to policyholders. Challenger guarantees a rate to MS Primary, which effectively includes Challenger's contribution toward marketing, distribution and administration costs in Japan. As such, for these products, Challenger incurs limited distribution and operational costs as part of its direct expense base.

The annuity relationship with MS Primary generated 15% of Challenger's FY18 annuity sales, in line with Challenger's expectation of $600m of sales for MS Primary in FY18.

Under the reinsurance agreement, the guaranteed interest rate on new business can be revised and has mechanisms to regulate volumes between MS Primary and Challenger. The agreement also includes usual termination rights for both parties, including material breach, failure to make payments and events that may be triggered by changes in MS Primary's regulatory environment.

Broadening the relationship with MS&AD

MS&AD's subsidiary, MS Primary, is a key Challenger annuity distribution partner. Challenger is broadening its relationship with MS&AD and both parties have identified potential growth opportunities.

Challenger has opened a Tokyo office to support the MS&AD relationship and to develop distribution opportunities in the region.

In recognition of the strategic importance of the MS&AD relationship and to facilitate Challenger's future growth, a $500m equity placement to MS&AD was completed on 23 August 2017.

The equity placement represented 6.3% of Challenger's issued capital. MS&AD subsequently increased its Challenger shareholding to ~10% of issued capital via on market acquisitions.

MS&AD's equity investment in Challenger underpins the strength of the relationship and they are supportive of Challenger's ongoing growth strategy.

Retirement income regulatory reforms update

The Australian Government is undertaking a range of reforms to enhance the retirement phase of superannuation and better align it with the overall objective of the system – providing income in retirement to substitute or supplement the age pension.

These reforms include:

- removing impediments to longevity product development through the Retirement Income Streams Review;
- introducing new means test rules for lifetime products; and
- creating a Retirement Income Framework.

New retirement income rules – Retirement Income Streams Review

As part of the Federal Budget in May 2016, the Government announced reforms to enable a wider range of retirement income products. The new product rules removed regulatory impediments to certain longevity products, including Deferred Lifetime Annuities (DLAs) and group self-annuitisation products. These products are expected to provide the building blocks for superannuation funds to develop Comprehensive Income Products for Retirement (CIPRs).

The new retirement income product regulations, which allow for a range of new longevity products, including DLAs, came into effect on 1 July 2017.

Challenger launched a DLA in September 2017 and was the first Australian life insurer to offer a DLA. Future DLA sales are expected to be supported by new means test rules for lifetime income streams, which commence on 1 July 2019.

New means test rules for lifetime products

Following the introduction of the new lifetime product regulations, the Department of Social Services undertook a review of the means test rules for lifetime retirement income streams, including lifetime annuities and new products, such as DLAs. The means test rules govern the eligibility and level of access to the Government provided Age Pension and are based on a retiree's level of income and/or assets owned.

In May 2018, the Government announced new means test rules, designed to support the use of lifetime income stream products, that will commence on 1 July 2019. The new rules will assess for complying products a fixed 60% of all pooled lifetime product payments as income, and 60% of the purchase price of the product an asset until 84, or a minimum of five years, and then 30% for the rest of the person's life.

These new rules will encourage the development of innovative products that can help retirees manage the risk of outliving their income, while ensuring a fair and consistent means test treatment for all retirement income products. These changes also pave the way for the development of CIPRs.

New Retirement Income Framework

The Financial System Inquiry (FSI) recommended trustees should pre-select for members a Comprehensive Income Product for Retirement (CIPR) to enable a seamless transition to retirement and deliver on the superannuation objective to provide income in retirement.

The Government has identified the retirement phase of the superannuation system is currently under-developed and there is limited availability and take-up of products that manage the risks people face in retirement, in particular the risk of outliving their savings. As a result, currently most people invest their superannuation savings in an account-based pension and withdraw only legislated minimum amounts, without being aware of all the choices.

The Government is developing a Retirement Income Framework to increase flexibility and choice for retirees and help boost living standards. The framework will ensure retirees have more retirement income products to choose from and the information they need to make a choice.

The Retirement Income Framework builds on the new retirement income product rules that commenced on 1 July 2017.

The first stage of the Retirement Income Framework is to include a Retirement Income Covenant in the Superannuation Industry (Supervision) Act 1993, requiring trustees to develop a retirement income strategy for their members. The Government is targeting legislating the covenant by 1 July 2019 for commencement on 1 July 2020.

A key feature of the Retirement Income Framework will be the requirement for trustees of superannuation funds to offer Comprehensive Income Products for Retirement (CIPRs) – products that provide individuals income for life, no matter how long they live.

The Government released a position paper on the Retirement Income Covenant in May 2018 and industry consultation closed in mid-June 2018.

Life balance sheet

$m	FY18	1H18	FY17	1H17	FY16	1H16
Assets						
Life investment assets						
Cash and equivalents	1,671.6	950.1	1,430.1	1,172.7	1,990.6	1,631.9
Asset backed securities	4,763.1	4,542.2	4,416.7	4,362.8	4,138.1	4,044.5
Corporate credit	5,293.1	5,584.2	4,568.2	3,985.4	3,186.8	2,811.2
Fixed income and cash (net)	**11,727.8**	**11,076.5**	**10,415.0**	**9,520.9**	**9,315.5**	**8,487.6**
Australian – Office	2,011.3	1,855.6	1,670.6	1,563.1	1,498.4	1,385.2
Australian – Retail	954.8	962.5	941.1	921.3	962.0	986.1
Australian – Industrial	159.5	152.0	170.1	195.6	188.3	98.6
Japanese	297.4	234.0	229.3	226.9	242.4	203.6
REITs and other	417.5	450.5	396.7	421.4	258.9	389.7
Property (net)	**3,840.5**	**3,654.6**	**3,407.8**	**3,328.3**	**3,150.0**	**3,063.2**
Equity and other investments	1,799.1	1,642.7	1,360.1	1,231.6	1,079.0	1,060.0
Infrastructure (net)	717.7	666.3	494.4	526.4	567.2	536.4
Life investment assets	**18,085.1**	**17,040.1**	**15,677.3**	**14,607.2**	**14,111.7**	**13,147.2**
Other assets (including intangibles)	509.5	644.1	479.7	389.4	516.0	460.1
Total assets	**18,594.6**	**17,684.2**	**16,157.0**	**14,996.6**	**14,627.7**	**13,607.3**
Liabilities						
Life annuity book	11,728.3	11,115.8	10,322.2	9,784.9	9,558.5	8,868.4
GIR[1] and Challenger Index Plus Fund liabilities	2,135.0	1,909.3	1,687.8	1,633.2	1,315.5	1,035.1
Subordinated debt	403.7	405.3	393.6	384.8	576.7	576.5
Challenger Capital Notes	805.0	805.0	805.0	345.0	345.0	345.0
Other liabilities	317.7	296.1	277.4	295.3	342.6	215.2
Total liabilities	**15,389.7**	**14,531.5**	**13,486.0**	**12,443.2**	**12,138.3**	**11,040.2**
Net assets	**3,204.9**	**3,152.7**	**2,671.0**	**2,553.4**	**2,489.4**	**2,567.1**

[1] Guaranteed Index Return (GIR).

Life investment portfolio overview

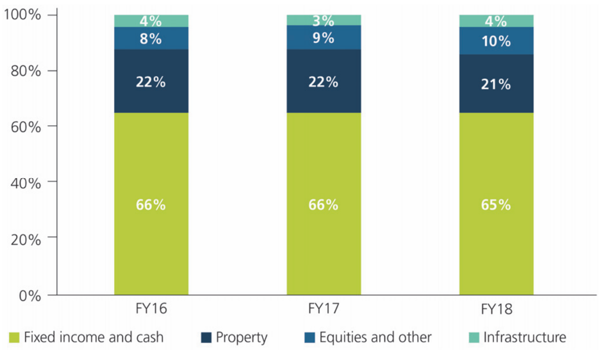
Life maintains a high quality investment portfolio in order to generate cash flows to meet future annuity obligations.

Life reviews its investment asset allocation based on the relative value of different asset classes, expected return on equity, and the tenor of annuity sales as Life maintains a cash flow matched portfolio. Accordingly, Life's investment asset allocation may vary from time to time.

Life's investment assets at 30 June 2018 comprised:

- fixed income and cash 65%;
- property 21%;
- equities and other investments 10%; and
- infrastructure 4%.

Detailed information on Life's investment assets is included on pages 32 to 40.



Fixed income portfolio overview

Life's fixed income and cash portfolio was $11.7bn (net of debt) at 30 June 2018, up 13% from $10.4bn at 30 June 2017. The fixed income and cash portfolio represented 65% of Life's investment assets at 30 June 2018.

Challenger manages credit risk by maintaining a high-quality investment portfolio and applying a rigorous investment process. The fixed income portfolio is diversified across different industries, rating bands, asset classes and geographies.

Life's policy liability cash flows are long-term in nature and contracted, providing the opportunity to invest in longer-dated and less liquid fixed income investments, allowing Life to earn an illiquidity premium on fixed income. The average fixed income illiquidity premium generated over the last five years has been between 1% and 2%.

The fixed income portfolio comprises over 1,300 different securities with 75% of the fixed income portfolio investment grade (i.e. BBB or higher) unchanged from 30 June 2017.

A total of 80% of the fixed income portfolio is externally rated (Standard & Poor's, Fitch or Moody's) and 20% based on internal ratings calibrated to Standard & Poor's or Moody's ratings framework.

The fixed income and cash portfolio is predominantly Australian focused, with approximately 68% of the fixed income portfolio invested in Australian-based securities.

Approximately 22% of Life's fixed income portfolio represents fixed income investments originated by Challenger. Direct fixed income origination includes senior secured loans, asset backed securities and commercial real estate lending. Life's direct origination capability has been in place for over 10 years and provides opportunities to capture additional earnings including illiquidity premiums.

Fixed income credit default experience

Challenger's normalised growth assumption for fixed income is negative 35 basis points, representing an allowance for credit default losses. In FY18, the credit default loss was -6 bps, outperforming the normalised growth assumption. Over the past five years the average credit default loss experience has been -11 bps per annum.

Detailed disclosure of Life's fixed income portfolio is included on pages 32 to 35. The fixed income disclosures include the following tables.

1. Table 1 – fixed income portfolio overview;
2. Table 2 – fixed income portfolio by credit rating;
3. Table 3 – fixed income portfolio by rating type;
4. Table 4 – fixed income portfolio by industry sector; and
5. Table 5 – fixed income portfolio by geography and credit rating.

Table 1: Fixed income portfolio overview

30 June 2018		$m	% portfolio	
Liquids		1,672	14%	Includes cash and equivalents and Government Bonds (net of repurchase agreements)
Asset Backed Securities (ABS)	RMBS	2,476	21%	Residential mortgage backed securities (RMBS). RMBS expertise developed when Challenger was Australia's largest non-bank securitiser of RMBS (via Mortgage Management business sold in 2009). Also includes NIM notes.
	Consumer finance	1,092	9%	Financing secured against underlying assets. Asset security includes motor vehicle, equipment and consumer finance.
	Senior Secured Bank Loans	537	5%	Senior debt secured by collateral and typically originated by Challenger.
	Aviation Finance	207	2%	Secured commercial aircraft financing.
	CMBS	451	4%	Commercial Mortgage Backed Securities (CMBS).
Corporate Credit	Banks and Financials	989	8%	Corporate loans to banks, insurance companies and fund managers.
	Infrastructure	1,568	13%	Long dated inflation linked bonds issued by Public Private Partnership projects and loans to infrastructure companies.
	Non-Financial Corporates	1,753	15%	Traded commercial loans to industrials and retailers.
	Commercial Real Estate	983	9%	Loans secured against commercial real estate assets and typically originated by Challenger.
Total		**11,728**	**100%**	

Table 2: Fixed income portfolio by credit rating

	Investment grade						Non-investment grade			Total
30 June 2018 ($m)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Liquids										
Government Bonds[1]	719	-	-	-	-	**719**	-	-	**-**	**719**
Cash and equivalents	953	-	-	-	-	**953**	-	-	**-**	**953**
Asset Backed Securities										
RMBS	-	856	462	583	312	**2,213**	127	136	**263**	**2,476**
Consumer finance	-	159	102	96	129	**486**	445	161	**606**	**1,092**
Senior Secured Loans	-	147	22	61	200	**430**	103	4	**107**	**537**
Aviation Finance	-	-	-	113	65	**178**	27	2	**29**	**207**
CMBS	-	36	46	66	107	**255**	187	9	**196**	**451**
Corporate credit										
Banks and Financials	-	-	223	215	409	**847**	117	25	**142**	**989**
Infrastructure	-	4	117	404	737	**1,262**	172	134	**306**	**1,568**
Non-Financial Corporates	-	-	10	169	550	**729**	675	349	**1,024**	**1,753**
Commercial Real Estate	-	29	12	326	408	**775**	104	104	**208**	**983**
Total	**1,672**	**1,231**	**994**	**2,033**	**2,917**	**8,847**	**1,957**	**924**	**2,881**	**11,728**
Fixed income portfolio %	14%	10%	8%	17%	26%	**75%**	17%	8%	**25%**	**100%**
Average duration (years)	0.0	1.9	2.7	3.8	3.7	**3.3**	3.0	4.4	**3.4**	**3.3**

	Investment grade						Non-investment grade			Total
30 June 2018 (%)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**%**
Liquids										
Government Bonds[1]	100%	-	-	-	-	**100%**	-	-	**-**	**100%**
Cash and equivalents	100%	-	-	-	-	**100%**	-	-	**-**	**100%**
Asset Backed Securities										
RMBS	-	35%	19%	24%	11%	**89%**	5%	6%	**11%**	**100%**
Consumer finance	-	15%	9%	9%	12%	**45%**	41%	14%	**55%**	**100%**
Senior Secured Loans	-	27%	4%	11%	38%	**80%**	19%	1%	**20%**	**100%**
Aviation Finance	-	-	-	55%	31%	**86%**	13%	1%	**14%**	**100%**
CMBS	-	8%	10%	15%	24%	**57%**	41%	2%	**43%**	**100%**
Corporate credit										
Banks and Financials	-	-	23%	22%	41%	**86%**	12%	2%	**14%**	**100%**
Infrastructure	-	-	7%	26%	47%	**80%**	11%	9%	**20%**	**100%**
Non-Financial Corporates	-	-	1%	10%	31%	**42%**	39%	19%	**58%**	**100%**
Commercial Real Estate	-	3%	1%	33%	42%	**79%**	11%	10%	**21%**	**100%**
Total	**14%**	**10%**	**8%**	**17%**	**26%**	**75%**	**17%**	**8%**	**25%**	**100%**

[1] Gross Government Bonds are shown net of $3,816m of Government Bonds that are held via repurchase agreements. Repurchase agreements are used to hedge movements in interest rates. Refer to page 41 for more detail.

Table 3: Fixed income portfolio by rating type

	Investment grade						Non-investment grade			Total
30 June 2018 ($m)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Liquids										
Externally rated	1,672	-	-	-	-	**1,672**	-	-	**-**	**1,672**
Internally rated	-	-	-	-	-	**-**	-	-	**-**	**-**
Asset Backed Securities										
Externally rated	-	1,163	629	759	474	**3,025**	244	75	**319**	**3,344**
Internally rated	-	34	3	162	338	**537**	645	237	**882**	**1,419**
Corporate credit										
Externally rated	-	34	362	1,112	1,844	**3,352**	642	415	**1,057**	**4,409**
Internally rated	-	-	-	-	261	**261**	426	197	**623**	**884**
Total	**1,672**	**1,231**	**994**	**2,033**	**2,917**	**8,847**	**1,957**	**924**	**2,881**	**11,728**
Externally rated	100%	97%	100%	92%	79%	**91%**	45%	53%	**48%**	**80%**
Internally rated	-	3%	-	8%	21%	**9%**	55%	47%	**52%**	**20%**

	Investment grade						Non-investment grade			Total
30 June 2018 (%)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**%**
Liquids										
Externally rated	100%	-	-	-	-	**100%**	-	-	**-**	**100%**
Internally rated	-	-	-	-	-	**-**	-	-	**-**	**-**
Asset Backed Securities										
Externally rated	-	35%	19%	23%	13%	**90%**	7%	3%	**10%**	**100%**
Internally rated	-	2%	-	11%	25%	**38%**	45%	17%	**62%**	**100%**
Corporate credit										
Externally rated	-	1%	8%	25%	42%	**76%**	15%	9%	**24%**	**100%**
Internally rated	-	-	-	-	30%	**30%**	48%	22%	**70%**	**100%**
Total	**14%**	**10%**	**8%**	**17%**	**26%**	**75%**	**17%**	**8%**	**25%**	**100%**

Table 4: Fixed income portfolio by industry sector

	Investment grade						Non-investment grade			Total
30 June 2018 ($m)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Industrials and Consumers	-	263	180	453	958	**1,854**	1,163	495	**1,658**	**3,512**
Residential Property	-	861	408	604	256	**2,129**	118	177	**295**	**2,424**
Banks, Financials & Insurance	953	5	242	240	418	**1,858**	170	26	**196**	**2,054**
Government	719	-	-	-	-	**719**	-	-	**-**	**719**
Commercial Property	-	48	47	329	497	**921**	292	71	**363**	**1,284**
Infrastructure and Utilities	-	4	117	404	739	**1,264**	172	134	**306**	**1,570**
Other	-	50	-	3	49	**102**	42	21	**63**	**165**
Total	**1,672**	**1,231**	**994**	**2,033**	**2,917**	**8,847**	**1,957**	**924**	**2,881**	**11,728**

	Investment grade						Non-investment grade			Total
30 June 2018 (%)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Industrials and Consumers	-	7%	5%	13%	28%	**53%**	33%	14%	**47%**	**100%**
Residential Property	-	36%	17%	25%	10%	**88%**	5%	7%	**12%**	**100%**
Banks, Financials & Insurance	46%	-	12%	12%	20%	**90%**	8%	2%	**10%**	**100%**
Government	100%	-	-	-	-	**100%**	-	-	**-**	**100%**
Commercial Property	-	4%	4%	26%	38%	**72%**	23%	5%	**28%**	**100%**
Infrastructure and Utilities	-	-	7%	26%	48%	**81%**	11%	8%	**19%**	**100%**
Other	-	30%	-	2%	30%	**62%**	25%	13%	**38%**	**100%**
Total	**14%**	**10%**	**8%**	**17%**	**26%**	**75%**	**17%**	**8%**	**25%**	**100%**

Table 5: Fixed income portfolio by geography and credit rating

	Investment grade						Non-investment grade			Total
30 June 2018 ($m)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Australia	1,443	1,015	714	1,255	1,958	**6,385**	1,139	469	**1,608**	**7,993**
United States	161	6	21	222	378	**788**	553	387	**940**	**1,728**
United Kingdom	22	26	35	235	294	**612**	26	-	**26**	**638**
Rest of World	19	123	105	143	88	**478**	70	2	**72**	**550**
Europe	25	32	68	88	152	**365**	95	5	**100**	**465**
New Zealand	2	29	51	90	47	**219**	74	61	**135**	**354**
Total	**1,672**	**1,231**	**994**	**2,033**	**2,917**	**8,847**	**1,957**	**924**	**2,881**	**11,728**

	Investment grade						Non-investment grade			Total
30 June 2018 (%)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Australia	18%	13%	9%	16%	24%	**80%**	14%	6%	**20%**	**100%**
United States	9%	-	1%	13%	23%	**46%**	32%	22%	**54%**	**100%**
United Kingdom	3%	4%	5%	37%	47%	**96%**	4%	-	**4%**	**100%**
Rest of World	3%	22%	19%	26%	17%	**87%**	13%	-	**13%**	**100%**
Europe	5%	7%	15%	19%	32%	**78%**	20%	2%	**22%**	**100%**
New Zealand	1%	8%	14%	25%	14%	**62%**	21%	17%	**38%**	**100%**
Total	**14%**	**10%**	**8%**	**17%**	**26%**	**75%**	**17%**	**8%**	**25%**	**100%**

Property portfolio overview

Life's property portfolio principally comprises directly held properties and is diversified across office, retail, and industrial properties.

Life's property portfolio was $3.8bn (net of debt) at 30 June 2018 and increased by $0.4bn (net of debt) in FY18 due to two direct property acquisitions and property valuation increases, partially offset by four property disposals. The property portfolio represented 21% of Life's total investment assets, down 1% from 30 June 2017.

Challenger Life has a policy that all properties are independently valued each year with approximately 50% valued in June and 50% valued in December. Internal valuations are also undertaken for properties not independently valued each June and December. An independent valuation is subsequently undertaken if the internal valuation shows a significant variance to the most recent independent valuation. In 2H18, independent valuations were obtained for 65% of the property portfolio.

Life's direct property valuations increased by approximately 4% in FY18, and exceeded Life's 2% per annum normalised capital growth assumption. Property valuation gains in FY18 were supported by the renewal of a number of long-term leases and tightening of cap rates in some market segments.

Property acquisitions incur stamp duty and acquisition costs. Under Australian Accounting Standards, property acquisition and transaction costs are required to be capitalised initially. When the property is subsequently revalued, there is generally no value ascribed to the acquisition costs which may result in a reduction in the property valuation and corresponding negative investment experience. During FY18, all properties acquired in FY17 were subject to either an independent valuation or a directors' valuation, with $8m of transaction costs (including stamp duty) offset against property valuation gains.

Property includes a net $297m exposure to Japanese property (8% of the property portfolio), consisting of suburban shopping centres that are focused on non-discretionary retailing. Property also includes a $223m investment in listed Australian REITs.

Rental income is diversified across sectors and tenants, with 52% (by FY18 gross rental income) of tenants classified investment grade (i.e. rated BBB or higher).

The Australian Government is a major tenant, leasing a range of commercial office buildings and accounted for approximately 32% of FY18 gross rental income[1].

Approximately 58% of contracted leases have either annual fixed increases or inbuilt increases based on inflation outcomes (e.g. CPI).

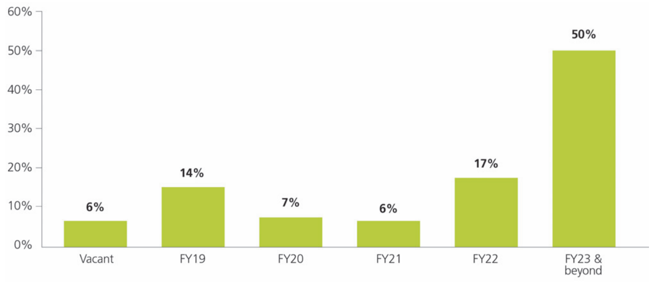
Full details of Life's property portfolio are listed on pages 37 to 39.

Property portfolio summary

% of total portfolio	FY18	FY17
Australian office	52%	49%
Australian retail	25%	28%
Australian industrial	4%	5%
Australian listed REITs	6%	5%
Australian unlisted REITs	4%	3%
Australian total	**91%**	**90%**
Japanese retail	8%	7%
Other (including offshore)	1%	3%
Total	**100%**	**100%**

Portfolio lease expiry overview[2]

The property portfolio generates long-term cash flows in order to match long-term liabilities. Approximately 50% of contracted leases expire in FY23 and beyond.



Reallocation from property to fixed income

Challenger applies a strong risk management approach with a focus on optimising normalised ROE.

With strong demand from offshore capital compressing property cap rates in certain sectors, the relative attractiveness of holding property over fixed income has recently reduced.

Challenger is in the process of disposing of a number of properties, with the proceeds released to be reinvested in fixed income investments.

Challenger expects the allocation to property to reduce from 21% at 30 June 2018 to mid-teens percentage by the end of FY19. Challenger is making good progress and has post 30 June 2018 disposed of its REITs investments ($0.2bn) and has sold one property and is well progressed with another (total $0.5bn). The property allocation is expected to be ~17% once these property sales settle.

1 Represents total gross passing income attributable to the direct property portfolio.

2 Direct property portfolio and jointly held assets only and excludes Australian REITs and development assets.

Direct property portfolio overview[1]

30 June 2018		Office	Retail	Industrial	Total
Total rent (%)[2]		52%	41%	7%	100%
WALE[3]		5.9	6.5	4.5	6.1
Tenant credit ratings					
	AAA	23%	-	-	23%
	AA	8%	1%	-	9%
	A	-	1%	1%	2%
	BBB	3%	12%	3%	18%
	BB	12%	13%	2%	27%
	B or below	-	2%	1%	3%
	Not rated	3%	9%	-	12%
	Vacant	3%	3%	-	6%
	Total	**52%**	**41%**	**7%**	**100%**
% of total gross net	Investment grade	34%	14%	4%	52%
	Non-investment grade	15%	24%	3%	42%
	Vacant	3%	3%	-	6%

[1] Direct property portfolio and jointly held assets only and excludes Australian REITs and development assets.
[2] Includes vacant floors/suites available for lease.
[3] Weighted Average Lease Expiry (WALE) assumes tenants do not terminate leases prior to expiry of specified lease term.

Direct property investments

30 June 2018			Acquisition date[1]	Total cost $m[2]	Carrying value $m	Cap rate FY18 %[3]	Last external valuation date
Australia							
	Office						
		14 Childers Street, ACT	01 Dec 17	97.1	92.2	6.75	30 Jun 18
		31 Queen Street, VIC	31 Mar 11	98.6	164.5	5.25	31 Dec 17
		35 Clarence Street, NSW	15 Jan 15	145.5	216.0	5.13	30 Jun 18
		53 Albert Street, QLD	12 Dec 14	222.9	236.2	5.88	30 Jun 18
		215 Adelaide Street, QLD	31 Jul 15	243.4	231.5	6.25	30 Jun 18
		565 Bourke Street, VIC	28 Jan 15	97.0	107.0	5.50	31 Dec 17
		82 Northbourne Avenue, ACT	01 Jun 17	60.9	57.5	6.00	31 Dec 17
		ABS Building, ACT	01 Jan 00	134.4	177.0	5.75	30 Jun 18
		County Court, VIC	30 Jun 00	216.8	306.7	6.13	31 Dec 17
		DIBP (formerly DIAC) Building, ACT	01 Dec 01	103.7	149.0	5.50	30 Jun 18
		Discovery House, ACT	28 Apr 98	88.9	131.0	5.63	30 Jun 18
		Executive Building, TAS	30 Mar 01	34.1	43.0	7.50	31 Dec 17
		Makerston House, QLD	14 Dec 00	68.1	70.7	7.38	31 Dec 17
	Retail						
		Bunbury Forum, WA	03 Oct 13	153.7	125.0	6.50	30 Jun 18
		Channel Court, TAS	21 Aug 15	81.9	82.5	7.00	30 Jun 18
		Gateway, NT	01 Jul 15	98.2	107.6	5.75	31 Dec 17
		Golden Grove, SA	31 Jul 14	151.4	159.8	6.00	31 Dec 17
		Karratha, WA	28 Jun 13	54.6	53.0	7.00	30 Jun 18
		Kings Langley, NSW	29 Jul 01	16.1	23.9	6.25	30 Jun 18
		Lennox, NSW	27 Jul 13	28.2	36.3	6.00	30 Jun 18
		Next Hotel, QLD	25 Mar 15	143.0	132.0	6.17	30 Jun 18
	Industrial						
		21 O'Sullivan Circuit, NT	27 Jan 16	47.6	39.3	8.00	31 Dec 17
		31 O'Sullivan Circuit, NT	27 Jan 16	28.8	25.9	8.25	31 Dec 17
		Cosgrave Industrial Park, Enfield, NSW	31 Dec 08	92.2	110.1	6.07	30 Jun 18
	Mixed use						
		The Barracks, QLD	31 Oct 14	153.9	151.5	6.25	30 Jun 18
Total Australia				**2,668.9**	**3,029.2**		

[1] Acquisition date represents the date of Challenger Life Company Limited (CLC's) initial acquisition or consolidation of the investment vehicle holding the asset.
[2] Total cost represents the original acquisition cost plus additions less full and partial disposals since acquisition date.
[3] The capitalisation rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regard to market evidence.

Direct property investments

30 June 2018			Acquisition date[1]	Total cost $m[2]	Carrying value $m	Cap rate FY18 %[3]	Last external valuation date
Japan							
	Retail						
		Aeon Kushiro	31 Jan 10	30.5	34.8	5.40	30 Jun 18
		Carino Chitosedai	31 Jan 10	118.4	129.6	4.60	31 Dec 17
		Carino Tokiwadai	31 Jan 10	77.0	81.0	4.60	30 Jun 18
		DeoDeo Kure	31 Jan 10	32.2	30.7	5.50	30 Jun 18
		Fitta Natalie Hatsukaichi	28 Aug 15	11.4	13.9	5.80	31 Dec 17
		Izumiya Hakubaicho	31 Jan 10	68.8	71.8	4.90	31 Dec 17
		Kansai Super Siago	31 Jan 10	13.1	13.4	5.50	30 Jun 18
		Kojima Nishiarai	31 Jan 10	12.2	14.9	4.30	30 Jun 18
		Life Asakusa	31 Jan 10	27.8	34.6	4.40	30 Jun 18
		Life Higashi Nakano	31 Jan 10	32.9	36.7	4.50	31 Dec 17
		Life Nagata	31 Jan 10	25.2	28.2	4.90	30 Jun 18
		MaxValu Tarumi	28 Aug 15	16.9	18.9	5.70	31 Dec 17
		Seiyu Miyagino	31 Jan 10	9.8	10.7	5.30	30 Jun 18
		TR Mall Ryugasaki	30 Mar 18	86.9	89.9	5.60	30 Jun 18
		Valor Takinomizu	31 Jan 10	26.9	24.7	5.70	31 Dec 17
		Valor Toda	31 Jan 10	42.5	44.6	5.40	30 Jun 18
		Yaoko Sakato Chiyoda	31 Jan 10	19.3	18.2	4.90	31 Dec 17
Total Japan				**651.8**	**696.6**		
Europe							
	Industrial						
		105 Route d'Orleans, Sully sur Loire	31 Dec 08	27.1	9.5	8.00	30 Jun 18
		140 Rue Marcel Paul, Gennevilliers	31 Dec 08	14.1	10.8	7.25	30 Jun 18
		ZAC Papillon, Parcay-Meslay	31 Dec 08	10.1	8.1	7.25	30 Jun 18
		Rue Charles Nicolle, Villeneuve les Beziers	31 Dec 08	18.5	14.1	7.00	30 Jun 18
	Retail						
		Avenue de Savigny, Aulnay sous Bois	31 Dec 08	20.3	12.5	6.50	30 Jun 18
Total Europe				**90.1**	**55.0**		
Total Overseas				**741.9**	**751.6**		
Development							
		839 Collins Street, VIC	22 Dec 16	74.9	74.9	-	-
		Gateway, NT	01 Jul 15	17.7	15.0	-	-
		Maitland, NSW	06 Dec 06	6.0	5.6	-	-
		North Rocks, NSW	18 Sep 15	153.8	146.1	-	-
		TRE Data Centre, ACT	14 Apr 10	13.6	13.5	-	-
Total development				**266.0**	**255.1**		
Total direct portfolio investments				**3,668.9**	**4,035.9**		

[1] Acquisition date represents the date of Challenger Life Company Limited (CLC's) initial acquisition or consolidation of the investment vehicle holding the asset.
[2] Total cost represents the original acquisition cost plus additions less full and partial disposals since acquisition date.
[3] The capitalisation rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regard to market evidence.

Equity and other portfolio overview

Life's equity and other portfolio of $1.8bn increased by $0.4bn (32%) in FY18. Equity and other investment represented 10% of Life's total investment assets at 30 June 2018, up from 9% at 30 June 2017.

Life's equity and other portfolio consists of beta investments, and alternative and other investments.

Listed beta equity investments of $376m represent investments in long only equities, including ETFs.

Unlisted beta equity investments of $227m represent investments managed by a range of third party investment managers. Beta investment returns are expected to be broadly correlated to listed equity market returns.

Alternatives and other equity investments of $1,196m represent a range of investments including absolute return funds, private equity, market neutral investment strategies and insurance linked investments. Returns are expected to have low correlation to listed equity markets.

Equity and other portfolio

30 June 2018 ($m)	Domestic	Offshore	Total
Listed beta	72	304	376
Unlisted beta	12	215	227
Alternatives and other	200	996	1,196
Total	**284**	**1,515**	**1,799**

Infrastructure portfolio overview

Life's infrastructure portfolio of $0.7bn (net of debt) increased by $0.2bn (45%) in FY18 and represented 4% of Life's total investment assets at 30 June 2018, up from 3% at 30 June 2017.

Challenger Life seeks infrastructure assets that generate reliable and consistent cash flows, which are preferably inflation linked, giving rise to sustainable income growth over time. Infrastructure investments comprise directly held infrastructure assets and indirectly held listed and unlisted investments.

Approximately 50% of the infrastructure portfolio is unlisted.

The infrastructure portfolio is diversified across a number of geographic regions and sectors.

Infrastructure portfolio by sector

30 June 2018	$m	%
Logistics	130	18%
Utilities	89	12%
Patronage	18	3%
Airport	44	6%
Power Generation	15	2%
Renewable	107	15%
Core infrastructure	315	44%
Total	**718**	**100%**

Infrastructure portfolio by geography

30 June 2018	$m	%
North America	202	27%
Australia	171	24%
United Kingdom	150	21%
Asia	56	8%
Europe	99	14%
South America	40	6%
Total	**718**	**100%**

Challenger Life Company Limited (CLC) debt facilities

$m	FY18	1H18	FY17	1H17	FY16	1H16
Repurchase agreements	3,816.0	3,387.9	3,287.5	3,482.9	2,454.2	1,875.1
Controlled property debt	560.5	491.9	534.5	535.8	572.9	652.9
Subordinated debt	403.7	405.3	393.6	384.8	576.7	576.5
Infrastructure debt	197.2	199.2	201.1	202.9	204.3	206.0
Other finance	15.0	16.0	17.0	17.8	18.8	19.5
Total CLC debt facilities	**4,992.4**	**4,500.3**	**4,433.7**	**4,624.2**	**3,826.9**	**3,330.0**

CLC debt facilities

CLC debt facilities include debt which is non-recourse to the Challenger Group and secured against assets held in investment vehicles by CLC, including direct properties and infrastructure investments. CLC debt facilities increased by $559m in FY18, due to an increase in repurchase agreements used to hedge interest rate movements (up $528m), and an increase in controlled property debt (up $26m).

Repurchase agreements

CLC enters into repurchase agreements whereby fixed income securities are sold for cash whilst simultaneously agreeing to repurchase the fixed income security at a fixed price and fixed date in the future. The use of repurchase agreements is part of Challenger's strategy to hedge interest rate movements.

CLC uses Australian Commonwealth and Semi Government Bonds with repurchase agreements, interest rate swaps and bond futures to hedge movements in interest rates on its asset portfolio, annuity policy liabilities, Guaranteed Index Return mandates, and the Challenger Index Plus Fund.

The Commonwealth and State Governments continued to increase supply and extend the duration of their bond curves. As a result, bonds provided a more cost effective hedge than swaps, particularly for longer dated liabilities.

Derivatives such as interest rate swaps and bond futures are self-financing, whereas the use of bonds requires repurchase agreement financing.

Challenger Life Company Limited (CLC) regulatory capital

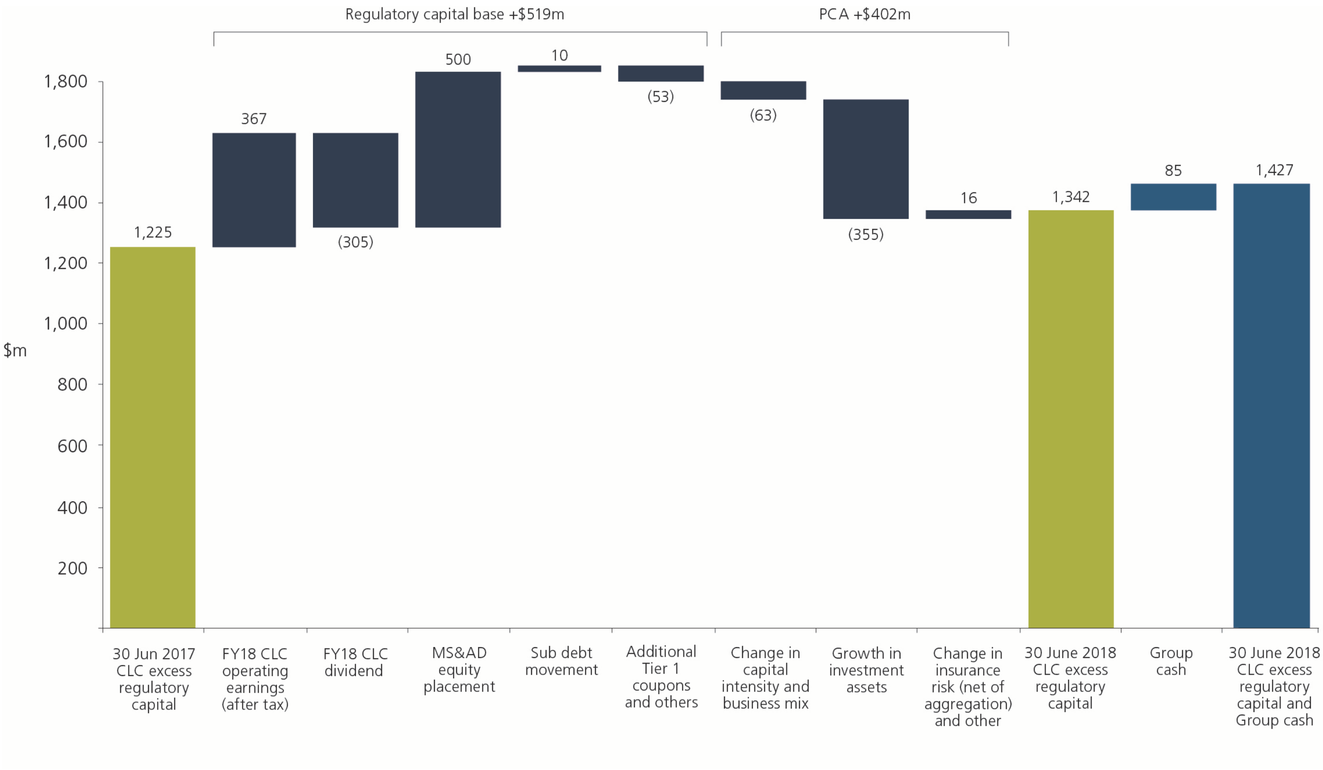
$m	FY18	1H18	FY17	1H17	FY16	1H16
CLC regulatory capital						
Common Equity Tier 1 (CET1) regulatory capital	2,677.8	2,638.4	2,169.0	2,046.0	2,003.6	1,951.8
Additional Tier 1	805.0	805.0	805.0	345.0	345.0	345.0
Tier 2 regulatory capital – subordinated debt[1]	405.4	406.8	395.4	386.7	445.5	477.5
CLC total regulatory capital base	**3,888.2**	**3,850.2**	**3,369.4**	**2,777.7**	**2,794.1**	**2,774.3**
CLC Prescribed Capital Amount (PCA)						
Asset risk charge	2,484.7	2,502.4	2,067.1	1,933.3	1,712.0	1,731.3
Insurance risk charge	70.0	164.9	157.5	152.7	168.3	132.7
Operational risk charge	46.4	42.8	38.7	34.9	28.7	22.7
Aggregation benefit	(54.8)	(125.7)	(119.2)	(115.5)	(125.3)	(100.4)
CLC PCA – excluding transition relief	**2,546.3**	**2,584.4**	**2,144.1**	**2,005.4**	**1,783.7**	**1,786.3**
Transition relief	-	-	-	-	-	(107.6)
CLC PCA	**2,546.3**	**2,584.4**	**2,144.1**	**2,005.4**	**1,783.7**	**1,678.7**
CLC excess over PCA	**1,341.9**	**1,265.8**	**1,225.3**	**772.3**	**1,010.4**	**1,095.6**
PCA ratio (times)	1.53	1.49	1.57	1.39	1.57	1.65
Tier 1 ratio (times)	1.37	1.33	1.39	1.19	1.32	1.37
CET1 ratio (times)	1.05	1.02	1.01	1.02	1.12	1.16
Capital intensity ratio (%)[2]	14.1%	15.2%	13.7%	13.7%	12.6%	13.6%

Tier 2 regulatory capital – subordinated debt[1]

Call date	Maturity date	FY18	1H18	FY17	1H17	FY16	1H16
24 Nov 2022	24 Nov 2042	405.4	406.8	-	-	-	-
7 Nov 2017	7 Nov 2037	-	-	395.4	386.7	378.0	374.7
7 Jun 2013	7 Dec 2016	-	-	-	-	33.4	67.6
7 Dec 2016	7 Dec 2026	-	-	-	-	34.1	35.2
		405.4	**406.8**	**395.4**	**386.7**	**445.5**	**477.5**

[1] FY18 Tier 2 regulatory capital – subordinated debt ($405m) differs to Life's balance sheet ($404m) due to accrued interest.
[2] Capital intensity ratio is calculated as CLC PCA divided by Life closing investment assets.

Movement in CLC excess regulatory capital and Group cash graph



Challenger Life Company Limited (CLC) regulatory capital

Capital management

CLC holds capital in order to ensure that under a range of adverse scenarios it can continue to meet its regulatory requirements and contractual obligations to customers.

CLC is regulated by the Australian Prudential Regulation Authority (APRA) and is required to hold a minimum level of regulatory capital. CLC has an ongoing and open engagement with APRA.

CLC's regulatory capital base and prescribed capital amounts have been calculated based on APRA prudential capital standards.

CLC excess regulatory capital

CLC's excess capital above APRA's Prescribed Capital Amount at 30 June 2018 (FY18) was $1.3bn.

CLC's regulatory capital base at 30 June 2018 was $3.9bn and increased by $0.5bn in FY18 due to the MS&AD equity placement ($0.5bn) in August 2017, with proceeds used to increase CLC's Common Equity Tier 1 Capital.

CLC's PCA at 30 June 2018 was $2.5bn and increased by $0.4bn in FY18, with the increase due to growth in Life's investment assets and an increase in capital intensity. Life's investment assets increased by $2.4bn or 15% in FY18.

CLC's 30 June 2018 PCA benefited from a reduction in the insurance risk charge, which also reduces the aggregation benefit. The insurance risk charge fell primarily due to updated mortality assumptions in respect of Life's wholesale longevity portfolio.

CLC's capital intensity, as measured by the PCA to investment assets increased from 13.7% at 30 June 2017 to 14.1% at 30 June 2018. The increase in capital intensity follows the equity placement to MS&AD with the new capital deployed into real estate investment trusts, listed infrastructure and alternatives. CLC's capital intensity is expected to fall as Life reduces its property allocation (refer to page 36 for more detail) and as the annuity book grows.

In 2H18, capital intensity reduced from 15.2% (at 31 December 2017) to 14.1% (at 30 June 2018). The reduction in capital intensity primarily reflects 2H18 annuity book growth backed by lower capital intense assets.

CLC's capital ratios at 30 June 2018 were as follows:

- PCA ratio of 1.53 times;
- Total Tier 1 ratio of 1.37 times; and
- Common Equity Tier 1 (CET1) ratio of 1.05 times.

APRA's Prudential Standards require Total Tier 1 capital to be at least 80% of the PCA and CET1 capital to be at least 60% of the PCA. Both Challenger's Total Tier 1 capital ratio (1.37 times) and CET1 capital ratio (1.05 times) are well in excess of APRA's minimum requirements.

CLC maintains a target level of capital representing APRA's prescribed capital amount plus a target surplus. The target surplus is a level of excess capital that CLC seeks to carry over and above APRA's minimum requirement to ensure it provides a buffer for adverse market or insurance risk experience.

CLC uses internal capital models to determine its target surplus, which are risk-based and responsive to changes in CLC's asset allocation and market conditions.

CLC does not target a fixed PCA ratio. CLC's internal capital models generate a PCA ratio range based upon asset allocation, business mix and economic circumstances. Based on this, CLC's target PCA range is currently 1.3 times to 1.6 times. This range may change over time.

Subordinated debt

In November 2017, CLC replaced its existing $400m Tier 2 subordinated debt instrument with new Tier 2 subordinated notes ($400m).

The subordinated notes qualify as Tier 2 regulatory capital under APRA's prudential standards and are floating rate notes, paying interest at a margin of 2.10% above the three-month Bank Bill swap rate. The subordinated notes mature in November 2042 with CLC having the option to redeem in November 2022, subject to APRA approval.

The subordinated notes include a holder conversion option which allows the note holder to convert the notes into Challenger ordinary shares in November 2024 if CLC has not already called the subordinated notes.

Group cash

In addition to CLC's excess regulatory capital, Challenger maintains cash at a Group level, which can be utilised to meet regulatory requirements. Group cash at 30 June 2018 was $85m, up $1m from 30 June 2017.

Challenger also maintains an undrawn Group banking facility of $400m, which is maintained to provide additional financial flexibility.

APRA's Level 3 (conglomerate) capital proposals

Challenger is a Level 3 entity under the APRA conglomerates framework. Level 3 groups are groups of companies that perform material activities across more than one APRA-regulated industry and/or in one or more non-APRA regulated industries.

APRA's non-capital conglomerate prudential standards relating to measurement, management, monitoring, reporting aggregate risk exposures and intragroup transactions and exposures came into effect on 1 July 2017. In March 2016, APRA announced that it would defer the implementation of conglomerate capital requirements until a number of other domestic and international policy initiatives were further progressed.

Profit and equity sensitivities

$m	Change in variable	Profit/(loss) after tax FY18	Change in equity FY18	Profit/(loss) after tax FY17	Change in equity FY17
Credit risk					
Fixed income assets (change in credit spreads)	+50 bps	(113.8)	(113.8)	(98.9)	(98.9)
	-50 bps	113.8	113.8	98.9	98.9
Policy liabilities (illiquidity premium change in credit spreads)	+50 bps	61.9	61.9	44.8	44.8
	-50 bps	(61.9)	(61.9)	(44.8)	(44.8)
Total	+50 bps	(51.9)	(51.9)	(54.1)	(54.1)
	-50 bps	51.9	51.9	54.1	54.1
Property risk					
Direct property	+1%	26.5	26.5	24.2	24.2
	-1%	(26.5)	(26.5)	(24.2)	(24.2)
Australian listed property securities	+10%	15.6	15.6	11.1	11.1
	-10%	(15.6)	(15.6)	(11.1)	(11.1)
Other property securities	+10%	9.9	9.9	10.1	10.1
	-10%	(9.9)	(9.9)	(10.1)	(10.1)
Total		52.0	52.0	45.4	45.4
		(52.0)	(52.0)	(45.4)	(45.4)
Infrastructure and equity risk					
Infrastructure investments	+10%	50.2	50.2	34.6	34.6
	-10%	(50.2)	(50.2)	(34.6)	(34.6)
Equity investments	+10%	125.9	125.9	95.2	95.2
	-10%	(125.9)	(125.9)	(95.2)	(95.2)
Total	+10%	176.1	176.1	129.8	129.8
	-10%	(176.1)	(176.1)	(129.8)	(129.8)
Life Insurance risk					
Mortality, morbidity and longevity[1]					
Life insurance contract liabilities	+50%	(19.7)	(19.7)	(12.9)	(12.9)
	-50%	19.7	19.7	12.9	12.9
Interest rate risk					
Change in interest rates	+100 bps	2.0	2.0	1.4	1.4
	-100 bps	(2.0)	(2.0)	(1.4)	(1.4)
Foreign exchange risk					
British pound	+10%	(0.4)	(0.4)	0.1	0.1
	-10%	0.4	0.4	(0.1)	(0.1)
US dollar	+10%	0.7	0.7	(0.1)	(0.1)
	-10%	(0.7)	(0.7)	0.1	0.1
Euro	+10%	(0.1)	(0.1)	(0.1)	(0.1)
	-10%	0.1	0.1	0.1	0.1
Japanese yen	+10%	0.2	0.8	-	0.2
	-10%	(0.2)	(0.8)	-	(0.2)
Other	+10%	0.2	0.2	(0.1)	(0.1)
	-10%	(0.2)	(0.2)	0.1	0.1

[1] Mortality, morbidity and longevity life insurance contract liabilities sensitivity is net of any reinsurance with third parties.

Profit and equity sensitivities

Profit and equity sensitivities set out the expected impact from changes in a range of economic and investment market variables on Challenger's earnings and balance sheet. These sensitivities represent the after tax impact on statutory profit, assuming a tax rate of 30%.

The sensitivities are not forward looking and make no allowance for events occurring after 30 June 2018.

If using these sensitivities as forward looking, an allowance for changes post 30 June 2018, such as sales and asset growth, should be made.

These sensitivities assess changes in economic, insurance and investment markets on the valuation of assets and liabilities, which in turn impact earnings. The earnings impact is included in investment experience and does not take into consideration the impact of any under or over performance of normalised growth assumptions for each asset category. Refer to page 53 for normalised growth assumptions.

These sensitivities do not include the indirect impact on fees for the Funds Management business.

Refer to the Risk Management Framework below for additional detail on how to apply the profit and equity sensitivities.

Risk Management Framework

CLC is required under APRA Prudential Standards to maintain regulatory capital in order to ensure that under a range of adverse scenarios it can continue to meet its regulatory and contractual obligations to customers.

Challenger is exposed to a variety of financial risks, including market risk (credit spread risk, currency risk, interest rate risk, equity risk), credit default risk, life insurance risk, liquidity risk, and operational risk.

The management of these risks is fundamental to Challenger's business and building long-term shareholder value.

The Challenger Limited Board is responsible, in conjunction with senior management, for understanding risks associated with the business and implementing structures and policies to adequately monitor and manage these risks.

The Board has established the Group Risk Committee (GRC) and Group Audit Committee (GAC) to assist in discharging certain responsibilities. In particular, these committees assist the Board in setting the risk appetite and ensuring Challenger has an effective Risk Management Framework, incorporating management, operational and financial controls.

The Executive Risk Management Committee (ERMC) is an executive committee, chaired by the Chief Risk Officer (CRO), which assists the GRC, GAC and Board in discharging their risk management obligations by implementing the Board approved Risk Management Framework.

The Group's Risk Management division has day-to-day responsibility for monitoring the implementation of the framework with oversight, analysis, monitoring and reporting of risks. The CRO provides regular reporting to the GRC, and the Board.

Risk appetite

Challenger's risk appetite requires a range of financial risks, including foreign exchange, interest rate, and inflation risk, to be minimised. As a result, Challenger takes an active approach to hedging and limiting these financial risks.

Challenger's risk appetite requires running a portfolio of asset and liabilities of a similar duration in order to reduce the risk of a duration mismatch.

Challenger's risk appetite statement provides that, subject to acceptable returns, and subject to limits, Challenger can retain exposure to credit risk, property risk, equity and infrastructure risk and life insurance risk.

Accept exposure (subject to appropriate returns)	**Minimise exposure**
✓ Credit risk	× Asset and liability mismatch risk
✓ Property risk	× Foreign exchange risk
✓ Equity and infrastructure risk	× Interest rate risk
✓ Life insurance risk	× Inflation risk
	× Liquidity risk
	× Licence risk
	× Operational risk

Asset and liability mismatch risk

Challenger seeks to run a matched portfolio of assets and liabilities and minimises the risk of a duration mismatch. Annuity cash payments are met from contracted investment cash flows together with assets held in Challenger's liquidity pool. As a result, liabilities and asset cash flows are well-matched and are continually rebalanced through time.

Credit default risk

Credit default risk is the risk of loss in value of an investment due to a counterparty failing to discharge an obligation.

Challenger's approach to credit management utilises a credit risk framework to ensure that the following principles are adhered to:

- credit risk management teams separation from risk originators;
- recognition of the different risks in the various businesses;
- credit exposures being systematically controlled and monitored;
- credit exposures being regularly reviewed in accordance with existing credit procedures; and
- ensuring credit exposures include the impact from derivative transactions.

Challenger makes use of external ratings agencies (Standard & Poor's, Fitch, Moody's) to determine credit ratings.

Where a counterparty or debt obligation is rated by multiple external rating agencies, Challenger will use Standard & Poor's ratings where available.

All credit exposures with an external rating are also reviewed internally and cross-referenced to the external rating, if applicable.

Where external credit ratings are not available, internal credit ratings are assigned by appropriately qualified and experienced credit personnel who operate separately from the asset originators.

Credit spread risk sensitivity

Challenger is exposed to price movements resulting from credit spread fluctuations through its fixed income securities (net of subordinated debt) and the fair value of annuity and other liabilities.

As at 30 June 2018, a 50 basis point increase/decrease in credit spreads would have resulted in an unrealised loss/gain of $114m (after tax) on fixed income investments (net of debt).

In accordance with Prudential Standards and Australian Accounting Standards, Challenger Life values term annuities at fair value and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Commonwealth Government bond curve plus an illiquidity premium. Movements in fixed income credit spreads impact the illiquidity premium.

As at 30 June 2018, a 50 basis point increase/decrease in credit spreads would have resulted in an unrealised gain/loss of $62m (after tax) on the fair value of annuity liabilities.

As at 30 June 2018, the net impact after considering both fixed income investments and annuity liabilities for a 50 basis point increase/decrease in credit spreads results in an unrealised loss/gain of $52m (after tax).

Property risk

Property risk is the potential impact of movements in the market value of property investments on Challenger's profit and loss.

Property risk sensitivity

Challenger is exposed to movements in the market value of property investments, both directly held investment properties and property securities.

The property sensitivities included on page 44 show the impact of a change in property valuations at balance date and are based on Life's gross property investments of $4.4bn (net investments of $3.8bn plus debt of $0.6bn). A 1% move in the direct property portfolio and 10% move in the indirect and other property portfolio at 30 June 2018 would result in a $52m movement in property valuations.

Infrastructure risk

Challenger is exposed to movements in the market value of listed and unlisted infrastructure investments. The infrastructure portfolio is diversified across a number of geographic regions and sectors, with approximately 75% of infrastructure investments offshore.

Equity risk

Equity risk is the potential impact of movements in the market value of listed equity investments, unlisted equity investments and investments in absolute return strategies. Returns for unlisted equity and absolute return strategies are generally uncorrelated to listed equity market returns.

Challenger holds equities as part of its investment portfolio in order to provide diversification across the investment portfolio.

Infrastructure and equity risk sensitivity

Challenger is exposed to movements in the market value of listed and unlisted infrastructure and equity investments. A 10% move in the infrastructure and equity portfolio at 30 June 2018 would have resulted in a $176m (after tax) movement in the valuation of infrastructure and equity investments.

Liquidity risk

Liquidity risk is the risk Challenger will encounter difficulty in raising funds to meet cash commitments associated with financial instruments and contracted payment obligations to annuitants. This may result from either the inability to sell financial assets at face value, a counterparty failing to repay contractual obligations, or the inability to generate cash inflows as anticipated.

Challenger's Liquidity Management Policy aims to ensure that it has sufficient liquidity to meet its obligations on a short, medium and long-term basis. In setting the level of sufficient liquidity, Challenger considers new business activities in addition to current contracted obligations.

In determining the required levels of liquidity, Challenger considers:

- minimum cash requirements;
- collateral and margin call buffers;
- Australian Financial Services Licence requirements;
- cash flow forecasts;
- associated reporting requirements;
- other liquidity risks; and
- contingency plans.

Required annuity cash outflows are met from contracted investment cash flows together with assets in Challenger's liquidity pool. As a result, cash flows are well-matched and continue to be rebalanced through time.

Life insurance risk

Lifetime annuities provide guaranteed payments to customers for life. Through selling lifetime annuities and assuming wholesale reinsurance agreements, CLC is assuming longevity risk, which is the risk annuitants live longer, in aggregate, than expected. This is in contrast to mortality risk, which is the risk that people die earlier than expected. CLC is exposed to mortality and morbidity risks on its wholesale mortality reinsurance business.

CLC is required under APRA Prudential Standards to maintain regulatory capital in relation to the longevity, mortality and morbidity risks it carries. CLC manages some of its longevity risk exposure by using reinsurance for closed lifetime annuity portfolios. CLC regularly reviews the portfolio for longevity experience to ensure longevity assumptions remain appropriate.

Mortality and morbidity rates are based on industry standards which are adjusted for CLC's own recent experience and include an allowance for future mortality improvements.

CLC assumes future mortality rates for individual lifetime annuities will improve by between 0% and 2.6% per annum, depending on different age cohorts. This has the impact of increasing the life expectancy of a male aged 65 from 22 years (per the base mortality rates) to 26 years.

Mortality, morbidity and longevity sensitivities

The mortality sensitivities on page 44 set out the expected impact of an improvement in mortality. This is in addition to the mortality improvements Challenger already assumes.

A 50% increase in the annual mortality improvement rates already assumed would increase the life expectancy of a male aged 65 from 26 years to 27 years and increase the policy liability valuations by $20m (after tax).

Foreign exchange risk

It is Challenger's policy to seek to hedge the exposure of all balance sheet items for movements in foreign exchange rates.

Currency exposure arises primarily as a result of Life's investments in Europe (including the United Kingdom), Japan and the United States. As a result, currency risk arises from fluctuations in the value of the Euro, British pound, Japanese yen and US dollar against the Australian dollar.

In order to protect against foreign currency exchange rate movements, Challenger enters into foreign currency derivatives which limit Challenger's exposure to currency movements.

Foreign exchange sensitivity

The impact of movements in foreign currencies on Challenger's profit and loss and balance sheet are set out on page 44. As a result of foreign currency derivatives in place, Challenger's profit and loss is not materially sensitive to movements in foreign currency rates.

Interest rate risk

Interest rate risk is the risk of fluctuations in Challenger's earnings arising from movements in market interest rates, including changes in the absolute level of interest rates, the shape of the yield curve, and the margin between different yield curves.

CLC's market risk policy sets out the relevant risk limits for interest rate exposure. It is CLC's policy to minimise the impact of interest rate movements on its projected future cash flows.

Interest rate sensitivity

The impact of movements in interest rates on Challenger's profit and loss and balance sheet are set out on page 44.

The sensitivities assume the change in variable occurs on 30 June 2018, and are based on assets and liabilities held at that date. It is Challenger's policy to minimise the impact of movements in interest rates via the use of interest rate swaps, Australian Commonwealth Government bonds and bond futures. As a result the interest rate sensitivities on page 44 show Challenger's profit is not materially sensitive to changes in base interest rates.

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Funds Management financial results

$m	FY18	FY17	FY16	2H18	1H18	2H17	1H17	2H16	1H16
Fidante Partners									
Fidante Partners income[1]	73.6	77.6	71.3	37.1	36.5	38.1	39.5	33.8	37.5
Performance fees	19.3	2.4	6.9	12.9	6.4	1.3	1.1	3.1	3.8
Net income	92.9	80.0	78.2	50.0	42.9	39.4	40.6	36.9	41.3
Challenger Investment Partners									
CIP income[2]	58.3	54.0	49.5	29.2	29.1	29.3	24.7	23.7	25.8
Total net fee income	**151.2**	**134.0**	**127.7**	**79.2**	**72.0**	**68.7**	**65.3**	**60.6**	**67.1**
Personnel expenses	(62.3)	(62.6)	(62.4)	(32.4)	(29.9)	(30.7)	(31.9)	(31.5)	(30.9)
Other expenses	(31.0)	(26.3)	(27.9)	(16.0)	(15.0)	(13.6)	(12.7)	(13.3)	(14.6)
Total expenses	**(93.3)**	**(88.9)**	**(90.3)**	**(48.4)**	**(44.9)**	**(44.3)**	**(44.6)**	**(44.8)**	**(45.5)**
EBIT	**57.9**	**45.1**	**37.4**	**30.8**	**27.1**	**24.4**	**20.7**	**15.8**	**21.6**
Performance analysis									
Fidante Partners – income margin (bps)[3]	17	17	19	18	16	16	18	18	20
CIP – income margin (bps)[3]	33	36	37	32	34	38	34	36	39
Cost to income ratio	61.7%	66.4%	70.7%	61.1%	62.4%	64.5%	68.3%	73.9%	67.8%
Net assets – average[4]	197.2	181.4	159.2	201.6	194.9	185.4	176.9	165.9	151.3
RoE (pre-tax)	29.4%	24.8%	23.5%	30.8%	27.6%	26.5%	23.2%	19.2%	28.4%
Fidante Partners	59,630	50,960	43,012	59,630	56,031	50,960	46,958	43,012	41,605
Challenger Investment Partners	18,354	15,945	13,650	18,354	17,397	15,945	15,155	13,650	13,093
Closing FUM – total	**77,984**	**66,905**	**56,662**	**77,984**	**73,428**	**66,905**	**62,113**	**56,662**	**54,698**
Fidante Partners	55,825	46,791	41,860	57,559	54,120	48,791	44,815	41,973	41,710
Challenger Investment Partners	17,575	15,006	13,248	18,272	16,853	15,725	14,308	13,346	13,128
Average FUM – total[5]	**73,400**	**61,797**	**55,108**	**75,831**	**70,973**	**64,516**	**59,123**	**55,319**	**54,838**
FUM and net flows analysis									
Fidante Partners[6]	3,872.3	4,125.8	(2,609.7)	1,375.3	2,497.0	2,384.8	1,741.0	1,332.1	(3,941.8)
Challenger Investment Partners	1,428.9	2,094.8	92.5	(8.4)	1,437.3	618.7	1,476.1	507.1	(414.6)
Net flows	5,301.2	6,220.6	(2,517.2)	1,366.9	3,934.3	3,003.5	3,217.1	1,839.2	(4,356.4)
Distributions	(657.7)	(504.2)	(541.1)	(318.6)	(339.1)	(248.2)	(256.0)	(203.1)	(338.0)
Market linked movement	6,434.7	4,527.4	1,817.6	3,507.4	2,927.3	2,037.1	2,490.3	327.6	1,490.0
Total FUM movement	**11,078.2**	**10,243.8**	**(1,240.7)**	**4,555.7**	**6,522.5**	**4,792.4**	**5,451.4**	**1,963.7**	**(3,204.4)**

1 Fidante Partners income includes equity accounted profits, distribution fees, administration fees, revenue share and Fidante Partners Europe transaction fees.
2 CIP income includes asset-based management fees and other income. Other income includes leasing fees, asset acquisition and disposal fees, development and placement fees.
3 Income margin represents net income divided by average FUM.
4 Net assets – average calculated on a monthly basis.
5 Average FUM calculated on a monthly basis.
6 Funds Management 1H16 and FY16 net flows include $5.4bn derecognition of Kapstream following the sale in July 2015.

Funds Management financial results

Funds Under Management and net flows

$m	Q4 18	Q3 18	Q2 18	Q1 18	Q4 17
Funds Under Management					
Fidante Partners					
Equities	26,349	24,373	24,295	23,343	22,365
Fixed income	25,036	24,699	24,299	23,237	21,808
Alternatives	8,245	8,275	7,437	7,110	6,787
Total Fidante Partners	59,630	57,347	56,031	53,690	50,960
Challenger Investment Partners					
Fixed income	12,346	13,134	12,290	12,538	11,051
Property	6,008	5,876	5,107	4,734	4,895
Total Challenger Investment Partners	18,354	19,010	17,397	17,272	15,946
Total Funds Under Management	**77,984**	**76,357**	**73,428**	**70,962**	**66,906**
Average Fidante Partners	58,489	56,575	54,121	52,604	50,046
Average Challenger Investment Partners	18,807	17,921	16,852	16,522	15,998
Total average Funds Under Management[1]	**77,296**	**74,496**	**70,973**	**69,126**	**66,044**
Analysis of flows					
Equities	(188)	404	(444)	647	809
Fixed income	230	242	770	1,491	1,161
Alternatives	(71)	758	(152)	185	31
Total Fidante Partners	**(29)**	**1,404**	**174**	**2,323**	**2,001**
Challenger Investment Partners	(685)	677	(2)	1,439	(32)
Net flows	**(714)**	**2,081**	**172**	**3,762**	**1,969**

[1] Average total Funds Under Management calculated on a monthly basis.

Reconciliation of Total Group Assets and Funds Under Management

$m	Q4 18	Q3 18	Q2 18	Q1 18	Q4 17
Funds Management (FUM)	77,984	76,357	73,428	70,962	66,906
Life investment assets	18,085	17,672	17,040	16,486	15,677
Adjustments to remove double counting of cross holdings	(14,926)	(15,476)	(13,945)	(13,903)	(12,595)
Total Assets Under Management	**81,143**	**78,553**	**76,523**	**73,545**	**69,988**

Funds Management financial results

Funds Management focuses on the retirement savings phase of Australia's superannuation system by providing products seeking to deliver superior investment returns. Funds Management is also expanding into international markets.

As one of Australia's fastest growing active asset managers, Funds Management invests across a broad range of asset classes including fixed income, commercial property and Australian and global equities. Funds Management comprises two business divisions, Fidante Partners and Challenger Investment Partners.

Fidante Partners forms long-term alliances with talented investment teams to create, support and grow specialist asset management businesses. Fidante Partners deep experience in asset management, extensive investor relationship networks and operational infrastructure enable investment teams to focus on what they do best, manage money.

Challenger Investment Partners (CIP) originates and manages assets for leading global and Australian institutions, including Challenger Life. CIP's clients benefit from a broad product offering and market insights, and in many instances co-invest with Challenger's Life business.

The Funds Management business is growing strongly, with funds under management (FUM) doubling over the last five years to $78bn.

EBIT and ROE

Funds Management EBIT was $58m and increased by $13m (28%) on FY17. The increase in Funds Management EBIT was due to higher net income (up 13%) partially offset by an increase in expenses (up 5%).

Funds Management ROE was 29.4% in FY18 and increased by 460 bps from 24.8% in FY17. ROE benefited from higher EBIT (up 28%) partially offset by a 9% increase in average net assets. Average net assets increased due to increased investments in new boutiques and the establishment of the Japanese office.

Total net fee income

FY18 net income was $151m and increased by $17m (up 13%) on FY17. Net fee income increased as a result of higher average FUM (up 19%) and higher Fidante Partners performance fees (up $17m), partially offset by lower Fidante Partners Europe capital raising transaction fees (down $12m). Refer to this page for more detail on Fidante Partners Europe.

Expenses

FY18 Funds Management expenses were $93m and increased by $4m (5%) on FY17. Personnel expenses were unchanged and other expenses increased by $5m. The increase in other expenses was due to expenses related to establishing economic partnerships with Latigo Partners and Garelick Capital Partners and some ongoing technology and distribution expenses.

The FY18 cost to income ratio was 61.7% and improved by 470 bps from 66.4% in FY17. The reduction in the cost to income ratio reflects the benefits of scale, with net income increasing by more than expenses.

Fidante Partners' net income

Fidante Partners' net fee income includes distribution fees, administration fees, transaction fees from Fidante Partners Europe, performance fees and a share in the equity accounted profits of boutique investment managers.

Fidante Partners' net income was $93m in FY18, up $13m (up 16%) from FY17. Fidante Partners' net income increased from higher average FUM (up 19%), higher performance fees (up $17m), partially offset by lower capital raising transaction fees from Fidante Partners Europe (down $12m).

Fidante Partners' income margin (net income to average FUM) was 17 bps in FY18 and was unchanged from FY17. The higher performance fees (+3 bps), were offset by lower Fidante Partners Europe capital raising transaction fees (-2 bps) and lower distribution fees (-1 bp).

Fidante Partners' FUM and net flows

Fidante Partners' FUM at 30 June 2018 was $59.6bn and increased by $8.7bn (17%) for the year. The increase in Fidante Partners' FUM for the year was due to:

- strong net flows of +$3.9bn; and
- positive investment markets net of distributions of +$4.8bn.

Fidante Partners' 30 June 2018 FUM is invested in the following asset classes:

- 44% in equities (FY17 44%);
- 42% in fixed income (FY17 43%); and
- 14% in alternatives (FY17 13%).

Fidante Partners Europe

Fidante Partners includes a European alternative investments group comprising interests in a number of specialist boutique fund managers, as well as a capital raising business serving the needs of listed, closed-end alternative investment companies. Fidante Partners Europe FUM was $6.2bn at 30 June 2018 and increased by 13% for the year.

Fidante Partners Europe is an important part of Funds Management's international distribution and product expansion. It provides a scalable platform to replicate Fidante Partners' multi-boutique platform in Europe and is helping to attract high quality fund managers. In FY18, two new US-based boutique managers were added to Fidante Partners Europe, adding $1.2bn of FUM during the period.

Challenger Investment Partners' net income

Challenger Investment Partners' net income was $58m in FY18, up $4m (8%) on FY17 due to higher average FUM. CIP average FUM was $17.6bn in FY18, up 17% on FY17.

Challenger Investment Partners FY18 income margin (net income to average FUM) was 33 bps in FY18, down 3 bps from FY17. The FY18 CIP income margin was impacted by lower property transaction fees (-1 bp) and a change in FUM mix (-2 bps). The change in FUM mix reflects an increased proportion of Life FUM managed by Challenger Investment Partners.

Challenger Investment Partners' FUM and net flows

Challenger Investment Partners' FUM at 30 June 2018 was $18.4bn and increased by $2.4bn (15%) for the year. The increase in Challenger Investment Partners' FUM was due to:

- strong net flows of $1.4bn; and
- positive market movement of $1.0bn.

Challenger Investment Partners' 30 June 2018 FUM is invested in the following asset classes:

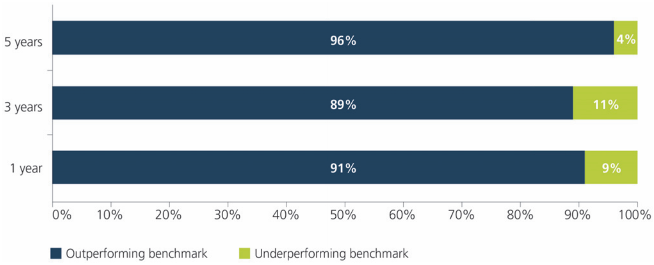
- 67% in fixed income (FY17 69%); and
- 33% in property (FY17 31%).

Third party clients accounted for 23% of Challenger Investment Partner's FY18 closing FUM, down from 24% in FY17. Third party fixed income and property net flows were positive in FY18, however the proportion of third party client FUM fell as a result of the growth in Life's FUM managed by CIP.

Funds Management investment performance

Investment performance represents the percentage of FUM meeting or exceeding performance benchmarks, with performance weighted by FUM.

Performance for both Fidante Partners and Challenger Investment Partners remains strong. Over a one year period, 91%[1] of FUM exceeded benchmark. Over five years, 96%[1] of FUM exceeded benchmark.



[1] Percentage of Fidante Partners' funds meeting or exceeding performance benchmarks over one and five years weighted by FUM.

Corporate financial results

$m	FY18	FY17	FY16	2H18	1H18	2H17	1H17	2H16	1H16
Other income	**1.0**	**0.8**	**1.0**	**0.5**	**0.5**	**0.4**	**0.4**	**0.4**	**0.6**
Personnel expenses	(41.8)	(38.5)	(37.1)	(21.7)	(20.1)	(20.7)	(17.8)	(19.1)	(18.0)
Other expenses	(10.4)	(11.9)	(13.0)	(4.6)	(5.8)	(6.1)	(5.8)	(6.6)	(6.4)
Total expenses (excluding LTI)	**(52.2)**	**(50.4)**	**(50.1)**	**(26.3)**	**(25.9)**	**(26.8)**	**(23.6)**	**(25.7)**	**(24.4)**
Long-term incentives (LTI)	(16.0)	(16.4)	(16.6)	(8.8)	(7.2)	(8.3)	(8.1)	(8.6)	(8.0)
Total expenses	**(68.2)**	**(66.8)**	**(66.7)**	**(35.1)**	**(33.1)**	**(35.1)**	**(31.7)**	**(34.3)**	**(32.4)**
Normalised EBIT	**(67.2)**	**(66.0)**	**(65.7)**	**(34.6)**	**(32.6)**	**(34.7)**	**(31.3)**	**(33.9)**	**(31.8)**
Interest and borrowing costs	(6.1)	(5.3)	(4.1)	(3.2)	(2.9)	(3.0)	(2.3)	(1.8)	(2.3)
Normalised loss before tax	**(73.3)**	**(71.3)**	**(69.8)**	**(37.8)**	**(35.5)**	**(37.7)**	**(33.6)**	**(35.7)**	**(34.1)**

The Corporate division comprises central functions such as group executives, finance, treasury, legal, human resources, risk management and strategy.

Corporate also includes interest received on Group cash balances and any interest and borrowing costs associated with Group debt facilities.

Normalised EBIT

Corporate normalised EBIT was a loss of $67m in FY18, down $1m on FY17 due to higher expenses.

Other income

FY18 other income increased slightly on FY17 to $1m, reflecting interest received on Group cash balances.

Group cash at 30 June 2018 was $85m and increased by $1m from 30 June 2017.

Total expenses

FY18 Corporate expenses were $68m and increased by $1m on FY17.

Corporate expenses include personnel costs of $42m, which were up $3m on FY17 as a result of an increase in employees and general salary increases.

Other expenses of $10m in FY18 were $2m lower than FY17.

Long-term incentive costs of $16m in FY18 relate to the non-cash amortisation of equity grants and were unchanged from FY17.

Interest and borrowing costs

FY18 interest and borrowing costs relate to debt facility fees on the Group's banking facility. FY18 interest and borrowing costs were $6m and increased by $1m on FY17.

The Group maintains a $400m banking facility in order to provide additional financial flexibility. The Group banking facility was undrawn throughout FY18.

Normalised cash operating earnings framework

Life normalised cash operating earnings is Challenger's preferred profitability measure for the Life business, as it aims to reflect the underlying performance trends of the Life business.

The Life normalised cash operating earnings framework was introduced in June 2008 and has been applied consistently since.

The framework removes the impact of market and economic variables, which are generally non-cash and a result of external market factors. The normalised profit framework is subject to a review performed by Ernst & Young each half year.

Life normalised cash operating earnings includes cash earnings plus normalised capital growth, but excludes investment experience (refer below).

Cash earnings

Cash earnings represents investment yield and other income, less interest expenses and distribution expenses.

Investment yield

Represents the investment return on assets held to match annuities and the return on shareholder investment assets.

Investment yield includes net rental income, dividend income, infrastructure distributions, accrued interest on fixed income and cash, and discounts/premiums on fixed income assets amortised on a straight line basis.

Interest expense

Represents interest accrued at contracted rates to annuitants and Life subordinated debt holders and other debt holders.

Distribution expenses

Represents payments made for the acquisition and management of Life's products, including annuities.

Other income

Other income includes revenue from Accurium and profits on Life Risk wholesale longevity and mortality transactions (refer to page 24).

Normalised capital growth

Normalised capital growth represents the expected capital growth for each asset class through the investment cycle and is based on Challenger's long-term expected investment returns for each asset class.

Normalised capital growth can be determined by multiplying the normalised capital growth assumption (see below) by each asset class's average balance for the period (net of debt).

Normalised capital growth assumptions for FY18 are as follows:

- Fixed income and cash – negative 0.35%, representing an allowance for credit default losses;
- Property – 2.00%;
- Infrastructure – 4.00%; and
- Equity and alternative asset classes – 4.50%.

Normalised capital growth assumptions have been set with reference to long-term market growth rates and are reviewed regularly to ensure consistency with prevailing medium to long-term market returns.

Investment experience

Challenger Life is required by accounting standards and prudential standards to value all assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on assets and policy liabilities being recognised in the profit and loss, particularly during periods of market volatility. As Challenger is generally a long-term holder of assets, due to them being held to match the term of life liabilities, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

Investment experience removes the volatility arising from asset and liability valuation movements so to more accurately reflect the underlying performance of the Life business.

Investment experience includes both asset and liability experience and net new business strain.

Asset and liability experience

Challenger Life is required by accounting standards and prudential standards to value all assets and liabilities supporting the Life business at fair value. Asset and liability experience is calculated as the difference between actual investment gains/losses (both realised and unrealised and based on fair value) and the normalised capital growth in relation to assets plus any economic and actuarial assumption in relation to policy liability changes for the period.

Changes in macroeconomic variables impact the value of Life's assets and liabilities. Macroeconomic variables and actuarial assumption changes include changes to bond yields, inflation factors, expense assumptions, and other factors applied in the valuation of life contract liabilities.

New business strain

In accordance with Australian Accounting Standards, Challenger Life values term annuities at fair value and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Commonwealth Government bond curve plus an illiquidity premium.

Life tends to offer annuity rates which are higher than these rates. As a result, on writing new annuity business, a non-cash loss is recognised when issuing the annuity contract due to a lower discount rate used to value the liability. In addition, maintenance expense allowances over the expected future term of new business are also included in the policy liability valuation.

New business strain is a non-cash item and subsequently reverses over the future period of the contract. The new business strain reported in the period represents the non-cash loss on new sales net of the reversal of the new business strain of prior period sales.

Glossary of terms

Terms	Definitions
Additional Tier 1 regulatory capital	High quality capital that provides a permanent and unrestricted commitment and is freely available to absorb losses but does not satisfy all the criteria to be included in Common Equity Tier 1 regulatory capital.
Capital intensity ratio	CLC Prescribed Capital Amount (PCA) divided by Life investment assets.
Cash earnings (Life)	Investment yield and other income less interest and distribution expenses.
CET1 ratio	Common Equity Tier 1 regulatory capital divided by prescribed capital amount.
CIP income	CIP income includes asset-based management fees, and other income such as leasing fees, acquisition and disposal fees, development and placement fees.
Common Equity Tier 1 regulatory capital	The highest quality capital comprising items such as paid-up ordinary shares and retained earnings. Common equity tier 1 capital is subject to certain regulatory adjustments in respect of intangibles and adjusting policy liabilities.
Distribution expenses (Life)	Payments made for the acquisition and management of annuities and other Life products.
Earnings per share (EPS)	Net profit after tax divided by weighted average number of shares in the period.
Fidante Partners' Income (FM)	Distribution and administration fees; Fidante Partners' share of boutique manager profits; and other income from boutique investment managers.
Funds under management (FUM)	Total value of listed and unlisted funds/mandates managed by the Funds Management business.
Group assets under management	Total value of Life's investment assets and Funds Management FUM.
Group cash	Cash available to Group excluding cash held by Challenger Life Company Limited.
Interest and borrowing costs (Corporate)	Interest and borrowing costs associated with group debt and group debt facilities.
Interest expenses (Life)	Interest accrued and paid to annuitants, subordinated debt note holders and other debt providers (including Challenger Capital Notes).
Investment experience (Life)	Represents fair value movements on Life's assets and policy liabilities and net new business strain. Refer to page 54 for more detail.
Investment yield (Life)	Net rental income, dividends received and accrued interest and discounts/premiums on fixed income securities amortised on a straight line basis.
Investment yield – shareholder funds (Life)	Represents the return on shareholder capital held by the Life business.
Life annuity book growth	Net annuity policy capital receipts over the period divided by the opening policy liabilities (Life annuity book).
Life book growth	Net annuity and other policy capital receipts over the period divided by the opening policy liabilities (Life annuity book, Guaranteed Index Return liabilities and Challenger Index Plus Fund liabilities).
Life investment assets	Total value of investment assets that are managed by the Life business.
Net annuity policy receipts	Life retail annuity sales less annuity capital payments.
Net assets – average (Group)	Average net assets over the period (excluding non-controlling interests) calculated on a monthly basis.
Net fee income (FM)	Fidante Partners' income, performance fees (FM), Challenger Investment Partners' income and performance fees.
Net Interest Margin (NIM)	Net interest margin on term funded prime mortgages and included as part of Life's investment assets.
Net management fees (FM)	Management fees for managing investments.

Glossary of terms

Terms	Definitions
Net tangible assets	Consolidated net assets less goodwill and intangibles.
New business tenor	Represents the maximum product maturity of new business sales. These products may amortise over this period.
Normalised capital growth	Long-term expected capital growth based on long-term return assumptions calculated as long-term capital growth assumption multiplied by average investment assets.
Normalised Cash Operating Earnings (NCOE) (Life)	Cash earnings plus normalised capital growth.
Normalised cost to income ratio	Total expenses divided by total net income.
Normalised dividend payout ratio	Dividend per share divided by normalised earnings per share (basic).
Normalised EBIT (Life)	Normalised cash operating earnings less total Life expenses.
Normalised EBIT (FM)	Net income less total expenses.
Normalised tax rate	Normalised tax divided by normalised profit before tax.
Normalised Return on Equity (ROE) – pre-tax	Normalised Life EBIT and FM EBIT or Normalised NPBT (Group) divided by average net assets.
Normalised Return on Equity (ROE) – post-tax	Group's normalised NPAT divided by average net assets.
Other expenses	Non-employee expenses, including external professional services, occupancy costs, marketing and advertising, travel, technology and communications costs.
Other income (Corporate)	Includes interest received on Group cash balances.
Other income (Life)	Relates to Accurium revenue and Life Risk. Refer to page 24 for more detail.
Performance fees (FM)	Fees earned for outperforming benchmarks.
Personnel expenses	Includes fixed and short-term variable incentive components of remuneration structures. The amortisation of long-term incentive plans is reported separately within the Corporate results.
PCA ratio	The ratio of the total CLC Tier 1 and Tier 2 regulatory capital base divided by the prescribed capital amount.
Prescribed capital amount (PCA)	Amount of capital that a life company must hold which is intended to be sufficient to withstand a 1 in 200 year shock and still meet adjusted policy liabilities and other liabilities. For further details refer to APRA's LPS110 Capital Adequacy.
Product cash margin (Life)	Represents the return on assets backing annuities and other income, less interest and distribution expenses.
Significant items	Non-recurring or abnormal income or expense items.
Statutory Return on Equity (ROE) – post-tax	Statutory NPAT divided by average net assets.
Tier 1 regulatory capital	Tier 1 regulatory capital comprises Common Equity Tier 1 regulatory capital and Additional Tier 1 regulatory capital.
Tier 2 regulatory capital	Tier 2 regulatory capital contributes to the overall strength of a Life company and its capacity to absorb losses but does not satisfy all the criteria to be included as Tier 1 regulatory capital.
Total expenses	Personnel expenses plus other expenses.
Total net income	Normalised Cash Operating Earnings (Life) plus net fee income (FM) plus other income (Corporate).

Key dates

Challenger Limited (CGF)	
Q1 19 Sales and AUM	17 October 2018
2018 Annual General Meeting	26 October 2018
2019 Half-year financial results	12 February 2019
Q3 19 Sales and AUM	24 April 2019
2019 Full-year financial results	13 August 2019
2019 Annual General Meeting	31 October 2019

Challenger (CGF) Final dividend 2018	
Ex-dividend date	31 August 2018
Record date	3 September 2018
DRP election date	4 September 2018
Final dividend payment date	26 September 2018