



CHALLENGER LIMITED  
ANNUAL GENERAL MEETING – CEO'S ADDRESS  
26 NOVEMBER 2012  
10:30AM  
THE WESLEY CENTRE  
220 PITT STREET SYDNEY

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Thank you Peter and good morning.

It's an honour to be addressing you, for the first time as CEO and Managing Director of Challenger.

I am fortunate to have been part of Challenger's senior management team for nearly 10 years, and I am extremely proud of what we have achieved. Challenger today is the leading provider of annuities and guaranteed retirement incomes and one of the fastest growing investment managers in the country.

But before I talk to you about Challenger's business, I'd like to talk to you about our customers.

In recent years Challenger has defined itself as a specialist retirement income provider. In doing so, it has been necessary to understand our customers who purchase and benefit from our retirement income products.

Only a few months ago, the marketing team conducted some focus group research with people who were either retired, or planning to do so within the next few years. The aim was to find out what people thought about retirement today, how they planned for it, what they invested in and of course, what they thought of annuities.

The most striking feedback obtained from today's retiree is that he, and she, has never been more uncertain about his or her financial future.

There is also an enduring concern about the medium-term performance of financial markets, which helps explain why annuities are growing at a rapid rate compared to other, non-guaranteed investment options.

What also struck us, was the fact that investors' horizon for concern has moved out from the short-term to the medium-term. That is, from where they would generate retirement income in the next 2-4 years to the next 5-10 years and beyond.

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**Further enquiry:** Stuart Kingham, Head of Investor Relations, Challenger Limited, 02 9994 7125  
Stuart Barton, General Manager of Marketing and Communications, Challenger Limited, 02 9994 7008

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This bodes well for longer-term retirement income products like annuities and helps explain why the average tenor of Challenger's new business has increased progressively from around 4 years to 6 years.

It also helps explain why we've recorded very significant increases in the sale of lifetime annuities, or more specifically, Challenger's Liquid Lifetime product.

People in their late 50s and 60s are seeing their parents living well into their 80s and 90s and are beginning to question the quality of life that they might be facing in a retirement that could run for up to a third of their lifetime.

Investing some of your superannuation in a lifetime annuity to insure against the risk of being old and very poor seems like an eminently sensible thing to do. Even more so if you could invest in an annuity that defers payments until you reached average life expectancy or when you expected your retirement savings to run out. This type of annuity represents a pure form of longevity insurance because it only kicks in when you really need it. Unfortunately due to unintended legislative oversights these products can't be feasibly offered in Australia at the moment but Challenger and others are speaking with Government about improving this situation.

We anticipate that Minister Shorten's Superannuation Roundtable, will support changes required to allow such deferred lifetime annuities to be offered. Challenger is well positioned to be the first to market with such products in Australia.

While annuities remain a relatively small part of the overall retirement products market in Australia, they continue to grow in popularity at a very rapid rate. In 2012, Challenger's annuity sales were four times greater than sales in 2009. If annuities grow to play as big a role in Australian retirement incomes as they do in other offshore markets, your company will enjoy a very bright future indeed.

Now turning to our business performance.

## **Business performance**

I am pleased to report that in 2012 we met or exceeded the targets and guidance provided for sales, net book growth and normalised cash earnings. We delivered record normalised net profit after tax; record earnings per share; and record retail annuity sales.

### **Slide 1 – 2012 financial performance**

Normalised profit rose 20% to \$297 million, with earnings increasing across both the Life and Funds Management businesses.

Normalised earnings of 57.5 cents per share represented an increase of 11% for the year.

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Dividends for the full year were 18 cents per share, an increase of 9% for the year.

Retail annuity sales rose by 34% to a record \$1.95 billion. We attribute this growth to the establishment of a dedicated distribution, product and marketing function to capitalise on the changing demographics and retiree risk preferences.

Total group assets under management rose 20% to over \$33 billion as at 30 June then lifted again in the September 2012 quarter to more than \$35 billion.

Statutory net profit after tax was \$149 million, which was, as mentioned by our Chairman, was impacted by volatile financial markets.

Unlike many financial institutions, we are required to value all assets and liabilities supporting our Life business at fair value. This means that daily market movements will result in positive or negative revaluations which we call investment experience.

Investment experience was negative in 2012 which explains why our statutory profit was less than our normalised profit. We expect the 2012 negative investment experience to largely reverse over time because the assets are of high quality and we typically hold them through to maturity. For 2013 year to date, we have experienced positive investment experience as markets have been better behaved. Our investment portfolio remains of a high quality with our fixed income portfolio being 86% investment grade at 30 June and the majority of our conservative property portfolio, leased to government tenants.

I am very pleased to report that Challenger has been growing faster than the two main markets in which it operates – retirement incomes and funds management. Revenues continue to accrete and the 2012 expenses have broadly remained at the same level as 2008.

With this operating leverage in our business, we have also lowered our targeted cost to income ratio to between 34% and 38%. At that level I think it's fair to say that Challenger is a very efficient financial services company.

## Capital

Life companies which guarantee payments to their customers must hold capital against these promises, in line with the requirements set out by our regulator, the Australian Prudential Regulation Authority. Life companies also hold a surplus amount in addition to this. As at 30 June 2012, Challenger held \$719 million of excess capital above our regulatory requirement. In addition, we had no group recourse debt, and had \$94 million of cash at group.

In August we announced that Challenger's regulatory capital will be required to increase by between \$110-125 million per annum for three years following the introduction of new capital

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standards for all life and general insurers. Last Friday we announced to the market that we expect this to be at the lower end of the range.

Under the new capital standards our Life companies subordinated debt will remain complying until call date and then amortise over a 5 year period. This means that the majority of our subordinated debt will qualify until November 2017 and will then reduce by 20% per annum until 2021. This provides a very comfortable timeframe to refinance the existing debt.

Uncertainty in relation to the impact of the new standards has weighed heavily on the company's share price this year, however I am pleased that as of Friday the transition arrangements have now been confirmed.

I would now like to provide an overview of the major initiatives and financial performance of both businesses, starting with Life.

## **Life**

Our Life business is the leading provider of annuities and guaranteed retirement income streams in Australia.

Challenger Life was again named the winner of the Plan for Life 'Annuity Provider of the Year' award. This is the fourth year in a row we have won and recognises our leadership in the annuities market.

Life's normalised cash operating earnings increased by 9% to \$436 million in 2012.

Retail annuity sales increased by 34% and have increased by a compound annual growth rate of 26% per annum since 2008.

Life's assets increased by 17% to \$9.8 billion as a result of the strong sales and business growth. Our assets are invested in a diverse and high quality portfolio, and will continue to generate sustainable earnings over time.

As mentioned by the Chairman, annuity sales are benefiting from the commencement of the baby boomer retirement phase and a recognition of the need for a differing investment approach in retirement. We expect these favourable macro business drivers and positive tailwinds to continue for many years.

## **Slide 2 – Distribution, product and marketing**

Annuity sales are also being amplified by our initiatives led by our Distribution, Product and Marketing division, which we have centralised to improve the co-ordination of these core business functions.

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We are seeing the benefits of this, with our initiatives built around thought leadership, product innovation, increasing brand awareness and enhancing the adviser and customer experience.

These initiatives are aimed at ensuring we achieve our objective of being recognised as “the leader in retirement income solutions in Australia”.

We have created a separate retirement incomes research capability, led by Jeremy Cooper, who was the chairman of the federal government’s superannuation review, and a leading commentator on Australia’s retirement system.

The research produced is thought provoking and focuses on retirement issues such as sequencing, inflation and longevity risks. Should you be interested in this research, there are some copies available in the room today.

We are responding to consumer demands for more dependable and stable incomes in retirement. We have launched a number of new innovative products, including the Challenger Guaranteed Pension Fund, which won the Plan for Life ‘Income Stream – Innovation’ award.

More recently we have launched the Care Annuity, the only product available that specifically targets the high growth aged care market.

A key initiative over the past two years has been to increase our brand awareness amongst financial advisers and consumers.

No doubt many of you have seen our ‘real stories’ advertising campaign on television. It has been running for over 18 months and runs on free-to-air and subscription television, cinema, radio, print and online.

The campaign has been extremely successful with consumers and financial advisers. Financial advisers today are almost three times more likely to think of Challenger first as a retirement incomes provider.

It has also been pleasing for the campaign to be recognised, winning a total of 6 advertising and marketing awards and we intend building on the success of ‘real stories’ with a new 2013 campaign, which will highlight the benefits of annuities.

We have also been very focused on making it easier for financial advisers and customers to interact with Challenger.

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We have rolled out a number of technology solutions to help achieve this. During the year we redesigned our market leading retirement income calculator, launched an internet based application tool and integrated our systems with financial adviser software. We also launched a dedicated web based support service for advisers.

If I can now turn to our funds management business.

## **Funds Management**

Funds Management earnings before interest and tax increased to \$21 million.

Our Funds Management business is one of Australia's fastest growing and is ranked by Rainmaker as Australia's tenth largest.

Across the year, funds under management increased by 31% to \$31 billion and the business attracted net inflows of \$4.2 billion, in what can only be described as difficult investment markets.

As Challenger's brand has progressively become more synonymous with retirement incomes and annuities, it was appropriate to distinguish and separately promote the alpha generating capability of our boutique partnerships under a different banner. To that end, we rebranded our boutique funds management business Fidante Partners.

### **Slide 3 – Fidante Partners**

Fidante Partners secured a further boutique fund manager during the year, acquiring a majority interest in Metisq Capital. Metisq has \$1 billion of funds under management and specialises in Asia-Pacific and Greater China equities strategies.

The Metisq acquisition is the first boutique added since 2010 and delivers a specialised emerging markets capability.

Following this acquisition, Fidante Partners now has 11 boutique fund managers, covering an array of different asset classes and styles.

The boutique funds management model has widespread support from investors and asset consultants. It is a contemporary model, with strong alignment of interests between boutique principals, investors and Challenger. The success of the model is evident with funds under management having grown from \$3 billion to \$21 billion in 3 years.

The growth in Fidante Partners has been supported by strong investment performance.

### **Slide 4 – 5 year scorecard**

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While our 1 year performance is pleasing, I would like to reflect on our performance over 5 years:

Since 2008 we've seen:

- Normalised profit after tax increase by 36%;
- Normalised earnings per share increase by 55% aided of course by our share buy-back;
- Significant sales growth in our annuity products; and
- Strong growth in funds under management.

It is only possible to sustain performance if you have talented and motivated people working for you every day, which is why Challenger is committed to a human resources strategy designed to deliver a competitive advantage.

We go to great lengths to listen to our people and gather their feedback on how they work at Challenger. This year, we conducted an independent survey to gain a better understanding of what drives their performance. Pleasingly, our employee engagement was assessed as well above the benchmark for the financial services sector and in the range of high performing companies.

## **Outlook**

Ladies and gentlemen, Challenger enters 2013 in good shape and is well positioned.

We have two robust businesses with competitive advantages operating in favourable markets.

For our Life business, we are seeing an ever increasing volume of money entering the retirement income phase each year due to the structural demographic changes. Advisers and retirees are becoming more aware of the need for increased income certainty in retirement which demands a differing investment approach.

We have a clear competitive advantage in this market as we are an independent provider with retirement incomes our core focus. Our success is demonstrated by our market leading position.

The significant change that the Australian funds management industry is undergoing provides opportunities for our business.

We believe that the contemporary Fidante Partners model is the right one, and we plan to grow both the size of the existing boutiques and introduce new ones over the coming years.

The forecast funds flow for this business is the largest it has ever been, and we look forward to continuing our strong growth.

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Capital is important to our business. In allocating capital we always seek to maximise long term shareholder returns. This requires balancing organic growth, accretive acquisitions and shareholder returns via dividends and buy-backs, such as the proposed increased buy-back activity that we announced today. Internally, we continue to target our 18% pre-tax Return On Net Asset hurdle when considering investing capital.

We also continue to provide shareholders with details of the performance targets we set for the year ahead. We agree these performance targets with the Board each year, and have a history of achieving them.

While less than five months into the 2013 financial year, we confirm our guidance on the following financial performance targets:

- Achieve Life cash operating earnings of between \$440 and \$450 million;
- Increase retail annuity sales by 15%, which translates into sales of \$2.25 billion; and
- Grow the size of the Life retail annuity book by 10%.

While these financial performance targets are challenging, we are making good progress on them and we will provide a further update to shareholders at our interim result announcement in February.

Before I hand back to Peter, I want to emphasise how much I am enjoying the opportunity to lead Challenger. We have a talented team, clear strategies in growth markets and are having a positive impact on Australian retirement incomes policy while striving to enhance shareholder value.

Despite the strong financial metrics that we have delivered over the past 12 months, the share price performance of Challenger has been disappointing. As I have mentioned, I suspect that the uncertainty surrounding the APRA capital changes has had an impact as well as the negative investment experience reported for the 2012 year.

We have now moved into a more positive setting. We now have certainty from APRA on LAGIC, have a very strong capital position, and have seen an improvement in global market volatility since 30 June delivering positive investment experience this year.

I would like to thank you for your continuing support.

I will be available following today's meeting, and I look forward to speaking further with you.

I'd now like to hand back to Peter.

Thank you.

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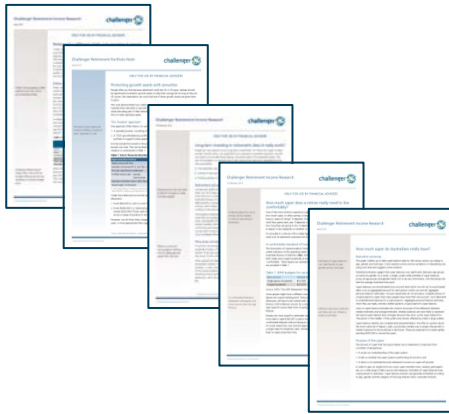
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# 2012 financial performance

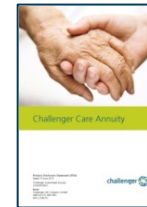
- Normalised NPAT up 20% to \$297m
- Normalised EPS up 11% to 57.5 cps
- Dividends up 9% to 18 cps
- Retail life annuity sales up 34% to \$1.95b
- Total AUM up 20% to \$33b
- Statutory NPAT of \$149m

# Distribution Product and Marketing

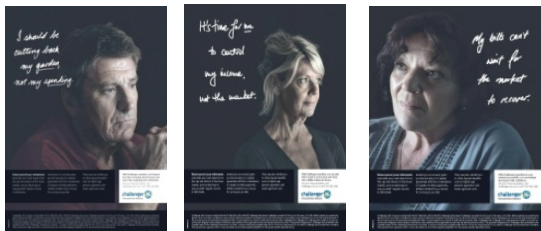
## Thought leadership



## Award winning product innovation



## Growing brand recognition



## Enhanced Adviser experience



# Fidante Partners



## Australian Equities



## International Equities

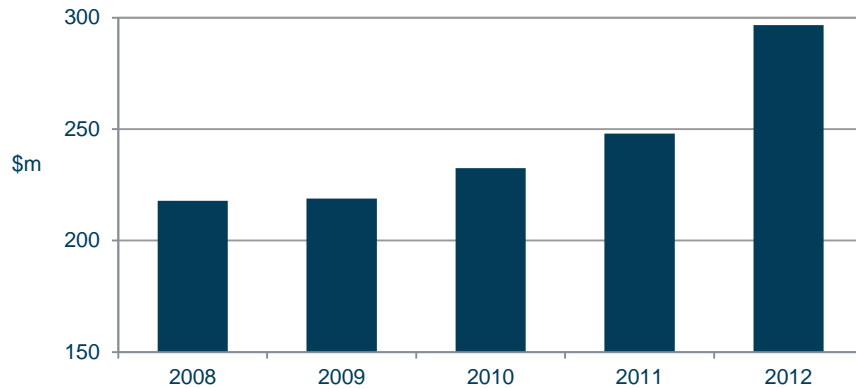


## Fixed Income

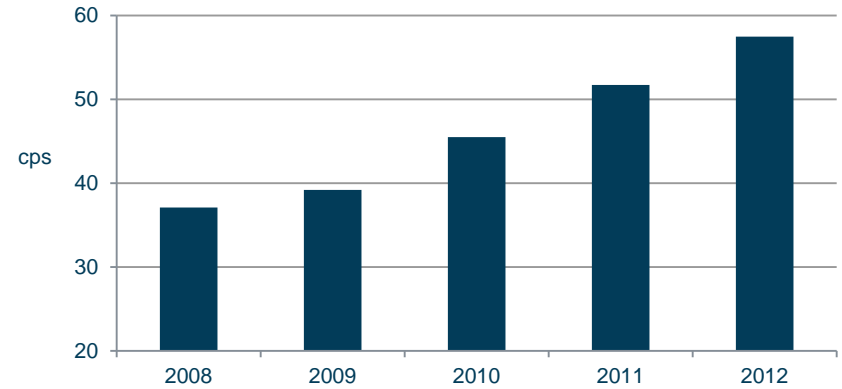


# 5 year scorecard

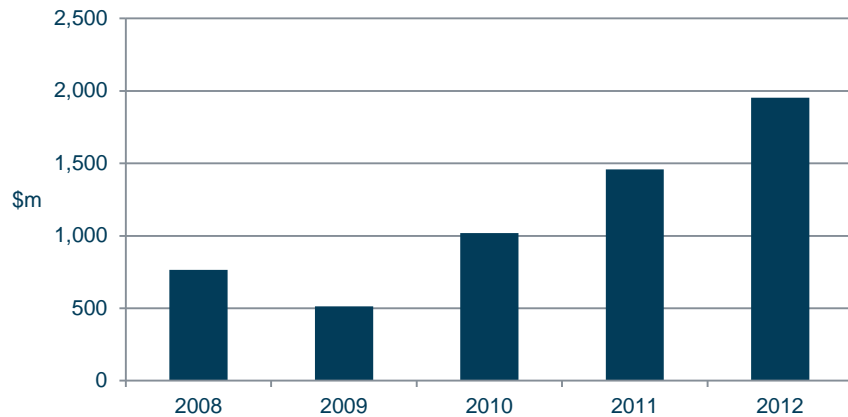
## Normalised net profit after tax



## Normalised earnings per share



## Life - retail sales of annuities



## Funds Management - funds under management

