Market release

2017 full year results

Challenger Limited
15 August 2017

RECORD RESULTS
POSITIONED FOR FUTURE GROWTH

- Group assets under management **$70.0** billion, up **17%**
- Average assets under management **$64.7** billion, up **12%**
- Normalised net profit before tax[1] **$505** million, up **8%**
- Normalised net profit after tax[1] **$385** million, up **6%**
- Statutory net profit after tax **$398** million, up **21%**
- Normalised pre-tax return on equity **18.3%**, up **50 bps**
- Normalised cost to income ratio improved **120 bps** to **33.4%**
- Full year dividend **34.5** cents per share, up **6%**
- Record annuity sales **$4.0** billion, up **20%**
- Funds Management net flows **$6.2** billion

Challenger Limited (ASX:CGF) today announced continued growth in the 2017 financial year, with record normalised net profit after tax, annuity sales and assets under management.

Challenger Chief Executive Officer Brian Benari said: “This has been a significant year for Challenger, delivering solid growth while implementing key strategic initiatives that position us extremely well for the future.

“Importantly all areas of our business contributed to our performance with outstanding net fund flows and unprecedented annuity sales driving a record $10 billion increase in assets under management.

“At the same time we are benefiting from our scalable business model with a 120 basis point reduction in our cost to income ratio to 33.4%, well below industry benchmarks – an outcome we expect to improve on further over the medium term.

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“Our strategic focus on expanding both our distribution relationships and product offering, has set a clear pathway for future growth. This is enabling us to significantly broaden our customer reach both domestically and offshore.

“During the year we announced plans to offer Challenger annuities via the platforms administered by AMP and BT. When these arrangements commence in the coming months, Challenger annuities will be represented on platforms used by two-thirds of Australia’s financial advisers.

“Our expansion into the Japanese annuity market has been very successful. Our new relationship with MS Primary, which sees us partner to provide Australian dollar annuities in Japan, delivered 15% of Life’s 2017 annuity sales.”

Group financial performance

Challenger’s performance in 2017 was underpinned by strong growth in assets under management, up 17% on the prior year.

Normalised net profit after tax was up 6% to $385 million. Statutory net profit after tax increased 21% to $398 million, reflecting positive investment experience of $13 million after tax.

Normalised pre-tax return on equity was 18.3%. Normalised earnings per share increased 6% to 68.5 cents. The full year dividend also increased 6% to 34.5 cents per share, fully franked.

Capital

Throughout the year Challenger ensured it remains well placed to fund future growth. The Challenger Capital Notes 2 issue in the third quarter of the year was very well supported by investors, resulting in the offer being increased in size to $460 million and issued at the lower end of the targeted margin range.

Challenger Life finished the year well capitalised with $1.2 billion of excess regulatory capital. This represents 1.57 times the Prescribed Capital Amount (PCA) ratio set by the Australian Prudential Regulation Authority (APRA), which is at the top end of Challenger’s target range of 1.3 times to 1.6 times.

Today Challenger has announced a $500 million strategic equity placement to MS&AD Insurance Group Holdings Inc., the parent company of Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary).

Following the MS&AD placement, which will be issued on 23 August 2017[2], Challenger Life’s 30 June 2017 pro forma PCA ratio increases to 1.75 times.

Life performance

Total FY17 Life sales were $5.0 billion, underpinned by significant growth in annuity sales, up 20% to $4.0 billion. Other Life sales contributed $1.0 billion, coming from new Guaranteed Index Return (GIR) client mandates and reinvestments, and the recently launched Challenger Index Plus Fund.

Life's total net book growth was a record $1.3 billion, or 12.1%, compared to 11.1% ($1.1 billion) in FY16. Importantly, this growth was achieved while actively reweighting to longer term business with the average tenor of new business sales lifting to 10.8 years, up from 6.5 years in FY16.

Long-term sales, which include lifetime annuities and 20-year maturity MS Primary (Japanese) business, accounted for 40% of FY17 sales, up from 17% of sales in 2016. Lifetime sales were up 70%. This increased weighting to longer term business improves the quality of Life's annuity book and reduces maturity rates over the medium term.

Life earnings before interest and tax (EBIT) increased 6% to $531 million. Life normalised cash operating earnings (COE) were up 7% to $631 million, driven by a 12% increase in average investment assets.

The COE margin was 4.29%, down from 4.49% in FY16. This movement was due to a reduction in return on shareholder capital driven by lower interest rates, a higher allocation to fixed income impacting normalised capital growth, and the impact of Life's changing product mix.

Funds Management performance

Funds Management achieved net flows of $6.2 billion for the year, well above industry averages. Average funds under management (FUM) rose to $61.8 billion, up 12% on the prior year driven by strong net flows and positive investment markets.

Normalised EBIT was $45 million, an increase of 21% with net income up 5% and expenses down 2%. Net income was up 5% to $134 million with higher average FUM-based fees, offset by lower performance fees. Excluding the impact of lower performance fees, net income was up 9%.

Implementing growth strategy

In FY17 Challenger implemented significant strategic initiatives that position the business for continued growth.

Expanding product range

Expanding the range of products on offer is enabling Challenger to meet the needs of a wider range of customers. This includes continuing to expand its stable of Funds Management boutiques, this year adding two new boutiques – Avenir Capital and Lennox Capital Partners, and adding seven new strategies to existing boutiques.

Challenger established a new relationship with Standard Life Investments, offering the Standard Life Investments absolute return global bond strategy in Australia under the Challenger brand.

This year also saw the launch of the Challenger Guaranteed Index Plus Fund, a new offering based on the GIR product that is targeted at Australian super funds. Challenger also expanded its range of Liquid Lifetime annuities.

Following the passing of enabling legislation and regulations, Challenger is now preparing for the launch of deferred lifetime annuities in the 2018 financial year, which will offer retirees pure longevity protection for the first time.

Growing distribution network

In FY17 Challenger continued to focus on expanding its distribution footprint. In addition to announcing plans with AMP and BT to make its annuities available on their platforms, Challenger launched annuities on the ClearView Wealth Solutions platform; added CarePlus to the Colonial First State platform; made Challenger annuities available to three profit-for-member funds through Link Group; and launched Challenger-backed annuities with Suncorp.

In Australia, the sale of annuities through investment and administration platforms is a key long-term growth driver. In FY17, annuity sales via these platforms grew by 80%.

Advisers continued to rate Challenger the leader in retirement incomes – including number one for technical and client services; business development; image and reputation; and overall adviser satisfaction, according to the industry benchmark Wealth Insights survey.

Broadening beyond Australia, the relationship with MS Primary has seen Challenger partner to provide Australian dollar annuities in Japan. This successful initiative has delivered 15% of Life's 2017 annuity sales.

Sustainable business practices

In FY17 Challenger maintained a strong focus on sustainable business practices, applying a rigorous risk management framework and continuing to build on the company's high performing culture.

Sustainable employee engagement, measured by Willis Towers Watson, remained high – five points above the norm for high performing companies globally.

Challenger has also substantially refreshed its approach to Corporate Sustainability which is reflected in the FY17 Sustainability Report, also released today. This report includes discussion of the matters that are material to Challenger including issues such as regulatory reform and long-term risk management.

Outlook

Challenger is well positioned with strong product offerings, expanding distribution networks and highly efficient operations.

For FY18 Challenger is targeting normalised net profit before tax of between $545 million and $565 million, representing growth of 8% to 12% on FY17.

The company continues to target an overall normalised pre-tax return on equity of 18%, noting that this will be impacted in FY18 by higher levels of capital until fully deployed.

Challenger expects to maintain a fully franked dividend payout ratio of 45 to 50% of normalised profit after tax, subject to prevailing market conditions and capital allocation priorities.

Investor presentation webcast

Challenger Managing Director and Chief Executive Officer, Brian Benari, and Chief Financial Officer, Andrew Tobin, will give an investor presentation on the results at 10:30am (Sydney time) on 15 August 2017. The presentation will be streamed live via webcast which can be accessed at www.challenger.com.au

1. The normalised profit figures are non-statutory amounts and in Challenger's view better reflect the underlying operating performance of the business. The normalised profit figures exclude investment experience and significant items. Investment experience is the difference between actual investment gains and losses (both realised and unrealised) and the normalised gains and losses (being based on Challenger's long term assumed returns), as well as any impact of changes in economic variables and assumptions used to value liabilities. The normalised profit also excludes any significant items which represent one-off or abnormal gains or losses for the period. The normalised profit framework and reconciliation to statutory profit have been discussed in Section 2 of the Operating and Financial Review in the 2017 Annual Report. The normalised profit is not audited but is subject to a review performed by Ernst & Young.

2. 38.3 new ordinary shares will be issued on 23 August 2017 at a 2% premium to Challenger’s 14 August 2017 30 business day volume weighted average share price of $12.9719, adjusted for the final FY17 dividend of 17.5 cents per share. The shares issued to MS&AD will not be eligible for Challenger’s final FY17 dividend.

Key metrics

	FY17	FY16	Change
Total assets under management ($bn)	70.0	60.1	17%
Average assets under management ($bn)	64.7	57.7	12%
Life book growth ($bn)	1.3	1.1	23%
Total Life sales ($bn)	5.0	4.4	14%
Annuity sales ($bn)	4.0	3.4	20%
Funds Management net flows ($bn)[1]	6.2	2.4	258%
Normalised NPBT ($m)	505	467	8%
Normalised NPAT ($m)	385	362	6%
Statutory NPAT ($m)	398	328	21%
Normalised EPS (cps)	68.5	64.6	6%
Statutory EPS (cps)	70.7	58.5	21%
Normalised ROE pre-tax (%)	18.3	17.8	50 bps
Statutory ROE post-tax (%)	14.4	12.5	190 bps
Normalised cost to income ratio (%)	33.4	34.6	(120 bps)
Full year dividend (cps)	34.5	32.5	6%

1. FY16 represents organic net flows and excludes boutique acquisitions and disposals.

About Challenger

Challenger Limited (Challenger) is an investment management firm with $70 billion* in assets under management. Its vision is to provide customers with financial security for retirement.

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

*30 June 2017.

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