Market release

Challenger Limited

11 August 2020

CHALLENGER ANNOUNCES FY20 RESULTS

- Group assets under management $85.2 billion, up 4%
- Normalised net profit[1] before tax $507 million, down 8%
- Normalised net profit[1] after tax $344 million, down 13%
- Statutory net loss[1] after tax $416 million, reflecting significant Life investment experience losses from pandemic market sell-off
- $1.6 billion of Challenger Life Company Limited excess regulatory capital
- Life sales up 13% reflecting strategy of diversification
- Funds Management net flows of $2.5 billion, outperforming broader market

Challenger Limited (ASX: CGF) today announced its results for the 2020 financial year, with solid growth in funds under management and improved Life sales across a more diversified base, offset by significant negative investment experience relating to the COVID-19 pandemic market sell-off.

Managing Director and Chief Executive Officer, Richard Howes, said: "While investment losses resulting from the major COVID-19 market event have impacted our net statutory performance, our strategy of growing funds under management and diversifying our revenue base demonstrates underlying business resilience.

"Total funds under management was up 4 per cent to $85 billion, notwithstanding both the fall in markets during the COVID-19 pandemic and the increased need for our superannuation fund clients to maintain higher levels of liquidity driven by financial market shifts and the federal government's early release scheme.

"We also achieved strong net flows across both institutional and retail channels in our Funds Management business with FUM up 3 per cent to $81.4 billion.

"Life sales are up 13 per cent, reflecting strong growth in institutional sales and an above target contribution from our partnership with MS Primary in Japan. The result in very challenging conditions demonstrates the benefits of our strategy to diversify our products and distribution channels.

"Life's wholesale longevity business completed three transactions in the UK pension market during the year. These transactions resulted in a significant increase in the value of future profits, which will also support future earnings growth."

"Our domestic annuities sales continue to be impacted by structural changes to the wealth management market, and this year have been additionally affected by new age pension means test rules and the COVID-19 disruption. We are quickly evolving our business in response to the changes, and we are seeing positive signs that we are well positioned to rebuild momentum in the new market environment. One example is the growth we are now achieving in lifetime annuity sales via independent financial advisers.

“We have reset the foundations of our domestic annuities business and have increased direct customer engagement and enhanced our product offerings, including the introduction of a new lifetime option designed to address customer concerns about investing in annuities in a low interest rate environment.

“The actions we’ve taken to provide targeted support to IFA channels, broaden our product range and deepen our engagement with institutional investors will drive growth in Challenger’s annuities business over time.

“At the same time, we continue to manage the business prudently, maintaining a very strong capital position well above our target range. We believe it is appropriate to hold high levels of capital in the current environment and will deploy up to $3 billion we hold in cash and liquids in a deliberate manner as appropriate opportunities arise over the course of FY21.”

Group financial performance

Group performance was affected by the severe impact of the COVID-19 pandemic on top of ongoing structural change to the financial advice industry, and broader operating environment.

Normalised net profit before tax (NPBT) was down 8% to $507 million. Normalised net profit after tax (NPAT) was down 13% to $344 million. Statutory net loss after tax was $416 million, including negative investment experience of $750 million, which represented fair value movements on Challenger Life assets and liabilities.

Group assets under management (AUM) were up 4%, finishing the year at $85.2 billion. The growth was particularly strong given the disruption in financial markets, and the federal government’s early release scheme for superannuation.

Normalised pre-tax return on equity (ROE) was lower at 14.8% and was 20 basis points above target.

Challenger achieved a normalised cost to income ratio of 35.7% with expenses up $17 million to $284 million, reflecting increased investment in distribution, product and marketing initiatives to address the structural changes in the market as flagged in FY19.

Given the uncertain conditions, investment market volatility and intention to maintain a strong capital position while optimising earnings, the Board has decided not to pay a final FY20 dividend.

Challenger Life

Normalised earnings before interest and tax (EBIT) was down $39 million to $525 million, with a $31 million fall in normalised cash operating earnings (COE) to $639 million and an $8 million increase in expenses. Life’s normalised ROE was 16.6%, down by 120 basis points.

Total Life sales were $5.2 billion, up $0.6 billion or 13%. This included higher Other Life sales, up $1 billion to $2 billion, offset by lower annuity sales, down $0.4 billion to $3.1 billion.

Strong growth in the contribution from MS Primary annuity sales in Japan, which were up 177%, supported a continuing shift to long term annuities[2] in the Life book. Long term annuities now represent more than half of the annuity book. The contribution from MS Primary was above the minimum annual target of ¥50 billion[3] and reflected the benefit of the expanded agreement to reinsure US annuities in Japan, which commenced on 1 July 2019.

The doubling of Other Life sales reflected the benefit of a diversified product offering with strong demand from institutions for the Index Plus product in the volatile market.

Domestic annuity sales were down $0.9 billion with the decline in term sales driven by a major structural change in the bank aligned advice networks. Lifetime annuities were also significantly impacted by the transition to new means test rules. While the new means testing rules are supportive of lifetime annuities, they require a period of adjustment as advisers become familiar with the lifetime annuity products that work best for customers under the new rules. In addition, COVID-19 has adversely impacted the ability of advisers to engage with their customers.

During the year, Challenger launched initiatives to respond to the changes in the market, including increased direct customer engagement via a Retire with confidence tool, and Retirement made simple digital hub. Challenger also refreshed its Index Plus product and added a new lifetime option with payments linked to the RBA cash rate.

Challenger also continues to improve customer engagement and education, while building stronger relationships with IFAs and establishing relationships with superannuation funds to develop retirement income solutions for customers.

Capital

Challenger has maintained a strong capital position following its successful $270 million institutional placement in June, and completion of its $35 million share purchase plan in July 2020. Challenger Life Company Limited has $1.6 billion in excess regulatory capital, putting it in a strong position to withstand further market volatility.

The PCA ratio[4] of 1.81 times is above the top end of the target range of 1.3 to 1.6 times the minimum amount set by the Australian Prudential Regulation Authority and the CET1 ratio[5] is 1.20 times. The PCA ratio is expected to move back toward the top end of the target range over the course of FY21 as cash and liquids are deployed into higher returning investments.

Challenger's financial strength is demonstrated by Standard & Poor's (S&P) 'A' credit rating for Challenger Life Company Limited and 'BBB+' for Challenger Limited, both with stable outlooks and reaffirmed by S&P in March 2020.

Funds Management

Funds Management performed strongly with net income up $8 million, or 5%, to $158 million. The strong underlying earnings was driven by FUM growth and higher performance fees. Earnings before income tax was up $7 million, or 13%, to $58 million.

Average FUM was $80.6 billion, up 4%, driven by strong cash inflows, outperforming the broader market.

Total net inflows for the Funds Management business were $2.5 billion, comprising $3.8 billion net inflows into Fidante Partners, with strong fixed income and equity flows, and a $1.3 billion outflow from CIP Asset Management, following changes to Challenger Life's investment portfolio in the second half of the financial year.

Outlook

Challenger expects normalised net profit before tax in FY21 in the range of $390 million to $440 million. This assumes Challengers Life's strong capital position will be prudently deployed over the course of the year with the deployment of up to $3 billion in cash and liquids into higher returning investments[6].

This reflects an intention to maintain defensive portfolio settings and carefully manage expenses.

Challenger maintains its through-the-cycle target for normalised pre-tax return on equity of the RBA cash rate plus 14 per cent. Performance against this target is heavily reliant on the speed of capital deployment and market conditions.

Challenger intends to gradually reduce its PCA ratio to the top end of its 1.3 to 1.6 times range. It maintains a target normalised dividend payout ratio of between 45% and 50% and expects to return to paying dividends in this range as conditions allow.

Investor presentation webcast

Challenger's Managing Director and Chief Executive Officer, Richard Howes, Chief Financial Officer, Andrew Tobin, Chief Executive, Distribution, Product and Marketing, Angela Murphy, Chief Executive, Life, Chris Plater and Chief Executive, Funds Management, Nick Hamilton will give an investor presentation on the results at 10:30am (Sydney time) on 11 August 2020. The presentation will be streamed live via webcast which can be accessed at www.challenger.com.au.

This release had been authorised by the Challenger Limited Board.

Key metrics

	FY20	FY19	Change
Total Group assets under management ($bn)	85.2	81.8	4%
CLC excess regulatory capital and Group cash ($bn)	1.7	1.5	18%
Life net book growth (%)	2.1	3.4	(130 bps)
Total Life sales ($bn)	5.2	4.6	13%
Annuity sales ($bn)	3.1	3.5	(12%)
Funds Management net flows ($bn)	2.5	(2.4)	n/a
Normalised NPBT ($m)	507	548	(8%)
Normalised NPAT ($m)	344	396	(13%)
Statutory NPAT ($m)	(416)	308	n/a
Normalised EPS (cps)	56.5	65.5	(14%)
Statutory EPS (cps)	(68.4)	50.9	n/a
Normalised ROE pre-tax (%)	14.8	15.8	(100 bps)
Normalised ROE post-tax (%)	10.0	11.4	(140 bps)
Normalised cost to income ratio (%)	35.7	32.6	310 bps
Full year dividend (cps)	17.5	35.5	(18.0c)

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 includes both assets and policy liability experience and net new business strain. 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. New business strain results from using the risk-free rate plus an illiquidity premium to value term and lifetime annuities. New business strain is a non-cash item and subsequently reverses over the future period of the contract. The normalised profit also excludes any significant items which represent non-recurring income and expense items for the period. The normalised profit framework and reconciliation to statutory profit have been discussed in Section 8 of the Operating and Financial Review in the 2020 Annual Report. The normalised profit is not audited but is subject to a review performed by Ernst & Young.
2. Long term annuities represent Lifetime annuities and MS Primary annuities.
3. This is subject to review in the event of a material adverse change for either MS Primary or Challenger.
4. PCA ratio represents total Challenger Life Company Limited (CLC) Tier 1 and Tier 2 regulatory capital base divided by the Prescribed Capital Amount (PCA).
5. CET1 ratio represents total CLC Common Equity Tier 1 regulatory capital base divided by the Prescribed Capital Amount.
6. The COVID-19 situation and its impacts on markets create an inherently uncertain environment. This could, among other things, impact the speed of deployment of Life's capital and therefore impact guidance.

ENDS

About Challenger

Challenger Limited (Challenger) is an investment management firm focusing on providing customers with financial security for retirement.

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

For more information contact:

Stuart Kingham
Head of Investor Relations
+61 401 139 067
skingham@challenger.com.au

Sean Aylmer
Head of External Communication
+61 409 817 039
saylmer@challenger.com.au

Mark Chen
Senior Investor Relations Manager
+61 423 823 209
machen@challenger.com.au