

Challenger Limited

Shareholder
Review 2014

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Challenger Limited is an ASX-listed investment management company established in 1985

Our vision and strategy

Challenger's vision is to provide Australians with financial security in retirement. Our teams are committed to achieving this goal, and their efforts are being invested in the following strategies to achieve our long-term vision.

Challenger's vision

Provide Australians with financial security in retirement

Challenger's strategies

- Increase the Australian retirement savings pool allocation to secure and lifetime income products
- Be recognised as the leader in retirement income solutions in Australia
- Be an active investment manager providing superior returns from platforms with alignment
- Deliver quality brands, products, service and platforms demonstrating value for money
- Drive a diverse culture where our people are highly engaged with a strong risk and compliance focus

Life

Leading provider of annuities and guaranteed retirement incomes in Australia

The Life business is regulated by the Australian Prudential Regulation Authority (APRA) and provides products aimed at investors seeking the security and certainty of guaranteed cash flows with protection against market, inflation and longevity risks.

Annuity premiums, along with shareholder capital, are invested in a diversified and high quality portfolio of assets to deliver predictable, long-term cash flows to meet commitments to our customers.

Funds Management

Australia's seventh¹ largest and one of the fastest growing investment managers

Challenger's Funds Management business comprises Fidante Partners and Challenger Investment Partners.

Fidante Partners comprises co-owned, separately branded, active fixed income and equity investment managers. Fidante Partners provides administration, distribution and partnership support to the investment managers and shares in the profits of the investment managers through its equity ownership.

Challenger Investment Partners originates and manages assets on behalf of the Life business and third-party investors. Challenger Investment Partners invests in fixed income and property assets.

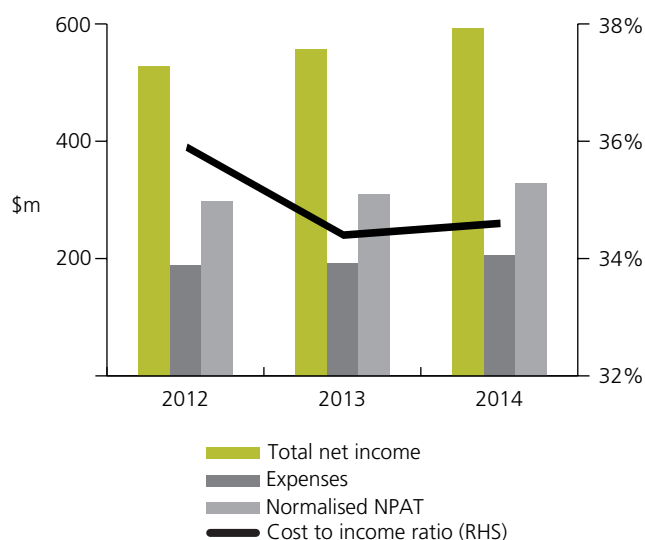
¹ Rainmaker Roundup – March 2014.

Results at a glance

Strong momentum with growth opportunities

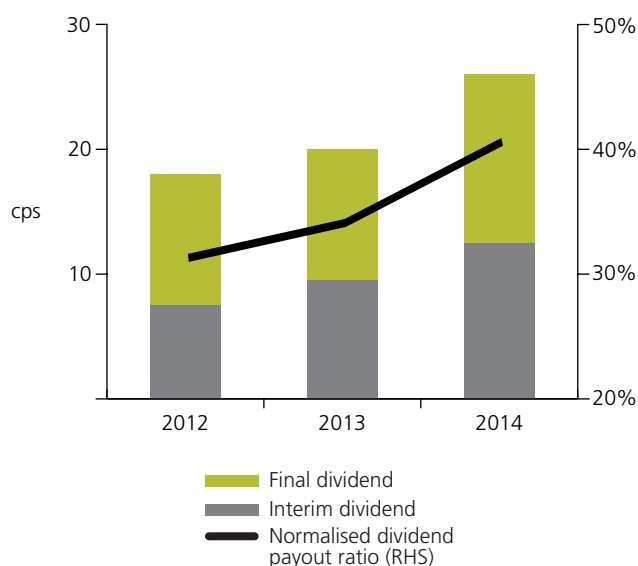
Financial performance

- 2014 normalised net profit after tax¹ (NPAT) increased by 7% to \$329 million
- Net income increased by 7% to \$593 million. Expenses increased by 7%, and cost to income ratio remained relatively stable
- Statutory NPAT¹ decreased to \$341 million, down from \$417 million, due to lower investment experience



Sustainable growth in shareholder returns

- 2014 dividends up 30% to 26.0 cents per share and payout ratio increased to 41%
- 2014 final dividend 40% franked
- 2015 dividend payout ratio target range increased to 45% to 50%² of normalised profit
- 2015 dividend franking expectations²
 - interim 70% franked
 - final 100% franked



¹ Challenger's normalised profit framework and reconciliation to statutory profit is disclosed in the Directors' Report on pages 31 to 33 of Challenger's 2014 Annual Report.

² Dividend payout ratio and franking subject to prevailing market conditions and capital allocation priorities.

Assets Under Management (AUM) continues to grow

Assets Under Management

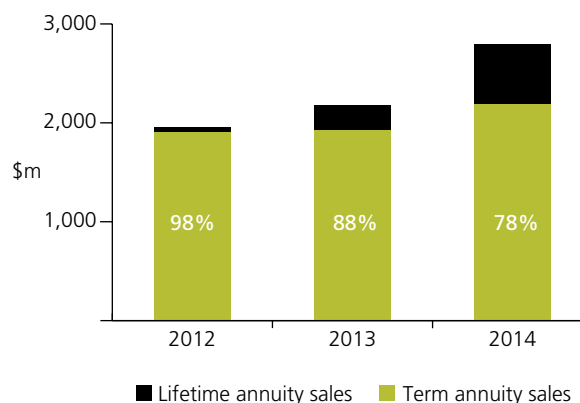
- Total AUM up 13% from \$44.8 billion to \$50.7 billion
- Life's AUM increased by 3% in 2014, driven by earnings and retail annuity sales, offset by retail and institutional maturities
- Funds Management FUM increased by 15% in 2014 as a result of strong Fidante Partners net flows and positive market impacts



Sales growing strongly and driven by demographic changes

Retail annuity sales

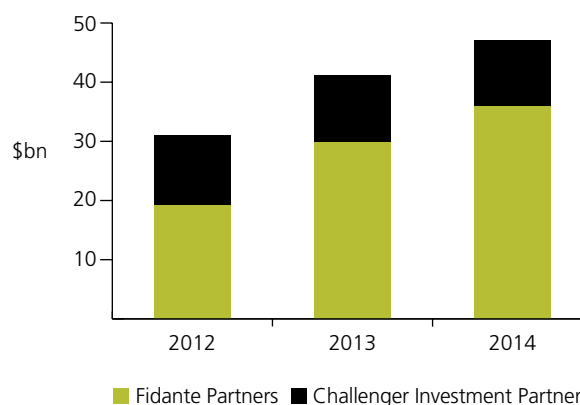
- Record 2014 retail annuity sales of \$2.8 billion, up 28%
- Lifetime sales represented 22% of 2014 total retail annuity sales, up from 12% in 2013



Funds Management – Strong Funds Under Management (FUM) and investment performance

Funds Management

- Fidante Partners FUM up 36% in 2014 from \$29.8 billion to \$35.9 billion
- Fidante FUM driven by strong investment performance and inflows of \$2.4 billion in 2014
- Challenger Investment Partners FUM of \$11.3 billion



Results at a glance

Key performance measures

	30 June 2014	30 June 2013	30 June 2012
Normalised profit after tax (\$m)	328.7	308.5	296.8
Statutory net profit after tax (\$m)	340.6	416.8	148.5
Normalised cost to income ratio (%)	34.6	34.4	35.9
Earnings per share			
Basic – normalised profit (cps)	64.0	58.6	57.5
Basic – statutory profit (cps)	66.3	79.2	28.8
Return on equity			
Normalised return on equity (RoE) – post-tax (%)	16.1	16.8	18.8
Statutory return on equity (RoE) – post-tax (%)	16.7	22.7	9.4
Dividends			
Dividend – interim (cps)	12.5	9.5	7.5
Dividend – final (cps)	13.5	10.5	10.5
Dividend – Total (cps)	26.0	20.0	18.0
Normalised dividend payout ratio (%)	40.6	34.1	31.3
Life sales and net flows			
Retail Life sales (\$m)	2,798.8	2,179.2	1,954.3
Institutional Life sales (\$m)	581.6	951.8	703.5
Total Life sales (\$m)	3,380.4	3,131.0	2,657.8
Life retail net flows ¹ (\$m)	887.1	598.1	582.9
Life retail net book growth ¹ (%)	12.5	9.1	10.4
Funds Management net flows			
Fidante Partners (\$m)	2,411.7	7,544.7	4,458.0
Challenger Investment Partners (\$m)	(264.3)	(566.1)	(232.0)
Total Funds Management net flows (\$m)	2,147.4	6,978.6	4,226.0
Total Assets Under Management (\$m)	50,725	44,770	33,429
Share price at 30 June (\$)	7.44	4.01	3.25
Market capitalisation at 30 June (\$m)	3,949.6	2,128.9	1,770.3

¹ Excludes \$284 million maturity of the High Yield Fund annuity in the 30 June 2014 period.

Chairman's report



Peter Polson
Chairman

With the growth of Australia's wealth and investment management industries underwritten by compulsory superannuation, it might be easy for some people to imagine that business success comes easily.

But it's also true that these situations usually breed fierce competition, making it critical for independent product providers like Challenger to adapt and innovate. Perhaps, most importantly, companies like ours must sometimes have the courage of conviction to commit to a path not followed by others.

Five years ago, Challenger made the decision to commit to what was regarded by others in the industry as a near-impossible goal – the re-establishment of Australia's longer-tenor and lifetime annuity markets. These markets were decimated in 2004 by the removal of supportive social security rules.

For shareholders, 2014 has been an especially good year, not only because Challenger's normalised profit, earnings per share and dividends continued to rise (the latter by 30%), or that our market capitalisation doubled to \$4 billion, but because your company's public advocacy efforts in the retirement income space appear to be making a helpful impact on government, academia and industry.

While Challenger is far from being the only proponent of the view that retirement investing has different objectives and additional risks which require its own specific products and policy settings, our contribution to the retirement income debate has been exceptional for one simple reason.

We were not content to just be 'thought leaders', but were prepared to actively invest, with an aim to also become product and sales leaders. We developed and marketed a lifetime annuity where the high level of sales has proven the intrinsic appeal of the product category.

With Challenger's retail annuity sales reaching a new record of \$2.8 billion this year, including a more than doubling of lifetime sales to \$613 million, the previously niche guaranteed annuity is becoming mainstream, with or without retirement policy reform.

Behind this phenomenon lies not only our ageing population, but also the widespread realisation that superannuation should be as concerned with sustainable spending in retirement as it is with saving enough beforehand.

The reason for the growth in Challenger's total assets under management of 13% to \$50.7 billion lies beyond the Company's achievements in the guaranteed income stream market.

Equally responsible is the continued growth of Funds Management and its Fidante Partners boutique platform, which today comprises 15 managers embracing multiple asset classes.

Another notable feature of the last five years has been a lifting of normalised profit by 50% and earnings per share by 63% using capital generated only from internal cash flow. This was achieved through a global financial crisis which saw other banks and insurers raising fresh capital.

For a company expanding as quickly as ours, there's clearly a limit to this approach. Given the organic growth opportunities which lie ahead, post 30 June your Board has decided to issue \$250 million in ordinary shares to institutions, and is undertaking a Share Purchase Plan available to retail investors, which is expected to raise an additional \$30 million. We also launched Challenger Capital Notes, a hybrid debt instrument to be listed and traded on the ASX, expected to raise \$360 million. This proactive approach to managing our capital base will ensure Challenger's future growth is not constrained. This equity issuance is expected to be earnings per share neutral for 2015 and accretive thereafter.

This capital raising will support retail annuity growth sufficient to drive Challenger Life's cash earnings to new levels, and is expected to further increase our earnings per share and dividends to shareholders. During 2015, these dividends are expected to be franked at 70% for the interim and 100% for final.

If you have any questions about this capital raising or any other matter, you will have the opportunity to ask them at this year's Annual General Meeting, the date of which has been brought forward to 28 October 2014.

This is a good time to be a Challenger shareholder.

I look forward to seeing you at the meeting.

A stylized, handwritten signature in black ink, appearing to read 'Peter Polson', with a long, sweeping horizontal line extending to the right.



Brian Benari
Chief Executive Officer

By a series of measures, 2014 has been very successful for Challenger and for you, our shareholders.

I am pleased to report that, like the annuities which account for much of our earnings, Challenger as a company has done what it said it would do. We continued to revive the lifetime annuity market, enhancing product features and breaking industry sales records along the way. We pursued the expansion of our funds management footprint, more than doubling our investment capacity through the addition of five new boutiques and new products for existing managers.

At a Group level, our Life and Funds Management divisions have now accumulated \$50.7 billion in assets and funds under management, a rise of 13% and which produced \$329 million of normalised net profit after tax, an increase of 7%.

Breaking this down further, a 24% increase in Funds Management's average FUM to \$44.4 billion produced normalised earnings before interest and tax (EBIT) of \$43 million, a rise of 27%. Net flows of \$2.1 billion helped lift balance-date FUM to \$47.1 billion, up 15% on last year and elevating Challenger to the position of Australia's seventh¹ largest fund manager.

In the annuities business, Life's \$11.1 billion balance sheet delivered a 6% rise in cash operating earnings to \$481 million. These earnings are largely a function of investment margin, which remained stable at 4.5%, and average assets under management, which grew by 6%. Retail net book growth of 12.5% slightly exceeded the top of our revised guidance range.

This is a very pleasing set of numbers, but what lies behind them is more significant.

An increase in retail annuity book growth means that the rolling off of shorter, fixed term annuities is increasingly being offset by the increase in longer-tenor and lifetime annuity sales. This year, sales of Challenger's lifetime annuities (Liquid Lifetime and Care) reached a striking \$613 million for the year, more than double last year's \$257 million and higher than any yearly lifetime sales result achieved by the entire Australian annuity industry.

While lifetime product is rapidly increasing as a percentage of overall retail annuity sales, sales of fixed term annuities continued to rise as well, resulting in an overall 28% increase in retail annuity sales to \$2.8 billion for the year, a very commendable achievement for our distribution, product and marketing teams.

When added to institutional sales, this retail annuity sales record helped Challenger to achieve a new total annuity product sales record of \$3.38 billion.

As mentioned in your Chairman's report, Challenger's Board and management formed the view, post balance date, that the size and immediacy of market growth opportunities warranted the raising of equity capital which is expected to be earnings per share neutral in 2015 and accretive in 2016. The majority of this capital has been earmarked to support the strong growth being achieved in our annuities business.

Most importantly, the new capital will ultimately support further earnings growth over the short, medium and long term, which will translate into higher dividends. When combined with a higher targeted dividend payout ratio range of 45% to 50% and the expected reintroduction of full franking for the FY15 final dividend.

Finally, many of you will be aware that the Government's Financial System Inquiry has been opining positively on the potential of annuities to provide a partial solution to the shortcomings of Australia's retirement system. It may recommend policy measures to encourage the broad uptake of lifetime annuities. In a similar vein, Federal Treasury has also re-opened discussions around the removal of impediments to the provision of new longevity products like deferred lifetime annuities. This could pave the way for innovative new products and more rapid penetration of the private pension market.

Undoubtedly 2014 will be remembered as a year when Challenger moved up a gear, and we are very much looking forward to how the next 12 months, and beyond, unfold.

¹ Rainmaker Roundup – March 2014.



Richard Howes
Chief Executive, Life

Richard Howes

Chief Executive, Life

Challenger Life Company Limited (CLC) is the leading provider of annuities and guaranteed retirement income solutions in Australia. Products appeal to investors seeking the security and certainty of guaranteed cash flows with protection against market, inflation and longevity risks.

Products are distributed via financial advisers, both independent and part of major dealer groups. Being an independent provider, CLC has representation on all major hubs.

CLC has won the Association of Financial Advisers/Plan for Life annuity provider of the year for the past six years.

CLC is an APRA regulated entity, with a requirement to hold capital to ensure that, under a range of highly adverse scenarios, CLC can continue to meet its regulatory and customer obligations. CLC is strongly capitalised, with approximately \$900 million of capital above APRA's minimum requirement at balance date.

Our business has been growing very strongly, with retail annuity sales increasing by 28% to \$2.8 billion in 2014. This growth is supported by favourable macro trends, including more baby boomers (born 1943-1960) retiring each year and retirees becoming more risk averse as they spend longer in retirement. These favourable macroeconomic trends are driving an increase in demand for our retirement income products.

Strong 2014 retail annuity sales, together with the benefit of longer tenor prior period sales, are helping to grow the size of our annuity business, with us achieving 12.5% book growth for the year¹.

Life's investment assets were \$11.1 billion at the end of the 2014 year, with investment assets near doubling over the past five years. In order to meet the promises to our customers, we match future annuity cash flow obligations with high quality assets generating dependable cash flows. Investment assets are primarily invested in fixed income (72% of the portfolio) and property (20% of the portfolio).

The fixed income portfolio is a diverse portfolio invested in corporate credit, asset backed securities such as residential mortgage backed securities, and cash equivalent investments.

With the significant increase in lifetime annuity sales (up 139% in 2014), we are increasing our property investments, acquiring \$0.4 billion of property (net of debt) during the year. Property is an attractive asset class because contracted rental receipts, which are often indexed to inflation, are a good match for long-term annuity payments.

During the year, we were successful in acquiring the units we did not already own in the listed Challenger Diversified Property Group (CDI). We regard CDI's property portfolio as attractive since it meets our return criteria and generates cash flows well suited to back annuities. Moreover, the properties are well known to us, as we co-owned a number of them with CDI.

Diversifying and extending Life's products and revenue streams is important, and we continually look for natural business adjacencies. Increasing Life's longevity and mortality exposures via wholesale reinsurance transactions is one such adjacency we have pursued in a careful and measured way. Over the year, we successfully executed four wholesale longevity/mortality reinsurance transactions, which delivered approximately \$6 million of additional profit for the year.

The Australian retirement incomes market is expected to grow strongly over the next 20 years as Australia's baby boomers move from retirement 'saving' to retirement 'spending'. Over this period, the number of Australians over 65 will increase by 75%. This is our target demographic, and we expect to benefit from the significant increase in potential customers. We are also well positioned to benefit from changes in retiree risk preferences, including the increased focus on longevity risk by retirees.

Annuities address many of the concerns retirees face today, and we are experiencing a significant increase in demand, particularly for longer-dated lifetime annuity products. We are amplifying this demand through market-leading distribution, product innovation and strong retirement income brand recognition.

¹ Excluding maturity of the Challenger High Yield Fund Annuity.

Funds Management



Rob Woods

Chief Executive,
Funds Management

Rob Woods

Chief Executive, Funds Management

Challenger's Funds Management business is Australia's seventh¹ largest investment manager and one of the fastest growing. Over five years, Funds under Management (FUM) has grown by over 180%.

Funds Management comprises Fidante Partners, a multi-boutique platform of co-owned, separately branded, active managers, and Challenger Investment Partners, a relative value manager investing on behalf of Life and third parties.

Funds Management has been growing quickly; FUM increased by 15% for the year to \$47 billion. The business is highly scalable, with increased FUM translating into higher earnings. Earnings before tax increased by 27%, with net income increasing by 11% and expenses by only 2%. Scale benefits are helping drive an increase in return on equity, which increased six percentage points to 33% pre tax.

The Fidante Partners business model aligns the interests of investors, boutique investment managers and Fidante Partners. The success of the model is resulting in Fidante Partners growing substantially faster than competitors, achieving net inflows of \$2.4 billion for the year. Investment performance has also remained strong, with 95% of all mandates and funds exceeding their benchmarks since inception.

Fidante Partners has been successful in attracting new investment manager talent, adding five new managers during the year across Australian equities, international equities, fixed income and infrastructure. In addition to adding new managers, additional capacity has been added to existing managers. There is approximately \$50 billion of available FUM capacity, which should support future business growth.

During the year, we rebranded Aligned Investments to Challenger Investment Partners. The rebrand was designed to provide a fresh and marketable brand as the business grows domestically and offshore and highlights the business' third-party client focus.

Over the past few years, Challenger Investment Partners has been growing new third-party relationships and attracting FUM, whilst closing a series of legacy products. During the year the Howard Mortgage Fund portfolio of loans was sold, with the fund now being wound up.

On 1 July 2014, Challenger Investment Partners' infrastructure business was merged with Access Capital Advisers, creating a \$4 billion Fidante Partners infrastructure boutique. Challenger Investment Partners is now a dedicated property and fixed income investment manager, with a strong focus on its third-party fiduciary business.

The Australian funds management market remains an attractive market underpinned by mandated superannuation contributions. Contributions increased to 9.5% of gross salaries on 1 July 2014 and will increase to 12% by 2025. The mandated nature of Australia's superannuation system is expected to significantly grow the size of Australia's superannuation assets from \$1.8 trillion today, to over \$7 trillion² in the next 20 years.

Challenger's Funds Management business is well positioned to benefit from this growth. Our platform has multiple brands and strategies with significant manager capacity. Coupled with Challenger's distribution capability and strong boutique investment manager performance, our Funds Management business is well positioned to continue increasing returns for shareholders.

¹ Rainmaker Roundup – March 2014.

² Deloitte – Dynamics of the Australian superannuation system.

Distribution Product and Marketing



Paul Rogan

Chief Executive,
Distribution, Product
and Marketing

Paul Rogan

Chief Executive, Distribution, Product and Marketing

Our vision is to provide Australians with financial security in retirement. Having quality brands, products, service and platforms is essential to achieve this vision.

The Distribution, Product and Marketing team is responsible for:

- distributing Challenger's retirement income and funds management products;
- increasing brand and consumer awareness;
- ensuring Challenger's product offering remains innovative, contemporary and relevant; and
- enhancing customer and adviser experiences.

Distribution

Both Life and Funds Management sales continue to benefit from the creation of specialist distribution teams. The Life team is focused on stable, secure retirement income annuity products for retirees. The Funds Management distribution team is focused on products providing superior investment returns across a variety of investment classes.

In 2014, we achieved record retail annuity sales, with sales increasing by 28% to \$2.8 billion. Annuity sales are benefiting from Australia's favourable demographic trends, with baby boomers commencing retirement and retirees seeking more stable and dependable retirement incomes.

Challenger's retail annuity sales are increasing, but also the mix of sales is continuing to evolve. Retirees are living longer than ever, and they are demanding retirement income solutions that provide longevity and inflation protection for life. This is helping to propel our lifetime annuity sales, with \$613 million of sales this year, up from \$257 million last year. Lifetime annuity sales represented 22% of total retail sales, up from only 2% in 2012.

Challenger is seeking to leverage its growth across distribution channels, including the self managed super fund (SMSF) sector. During the year, we acquired Bendzulla Actuarial, the leading provider of SMSF actuarial certificates, which has relationships

with approximately 5,500 accounting firms. We are repositioning Bendzulla to be a more broad-based SMSF retirement specialist and are developing a range of new SMSF offerings to help achieve this.

Challenger's Funds Management business continues to gain traction with both retail platforms and institutional investors, attracting over \$2 billion of net inflows for the year. Investors are attracted to the Fidante Partners business model, which has strong support from asset consultants due to the alignment between investment managers and investors.

Fidante Partners net inflows continue to benefit from the strong investment performance achieved by our boutique investment managers.

Challenger's distribution capability is highly regarded by financial advisers. Wealth Insights, an independent market researcher, recently ranked Australia's top 40 fund managers, with Challenger ranked number one in overall adviser satisfaction. We also have the number one business development team for the second year running, and our technical services team and client services team were also ranked number two.

Advisers clearly value what Challenger does and how we do it, resulting in advisers recognising Challenger as the leader in retirement incomes.

Product

Challenger has a proven track record in product innovation and continues to lead the market in retirement income product and service innovation, which is reigniting Australia's long-term annuities market.

Research shows that retirees are looking to protect themselves against longevity risk, seeking peace of mind in retirement through secure and reliable income products, and want the ability to access their funds during the life of a product. Through our lifetime annuity product innovation, we are addressing these retiree needs.

Our product innovation continues to be externally recognised, with Challenger's Liquid Lifetime Annuity named the 'Best Longevity Fund 2014' at the Chant West/Conexus Financial Super Fund Awards. In determining the winner, Chant West recognised the product's unique features, strong sales result, and our

Distribution, Product and Marketing

commitment to educating advisers on product features and benefits.

Following strong adviser demand, we have expanded our leading technical services capability. This team's sole focus is supporting advisers and helping them become retirement income and aged care specialists. Our technical services team provides online tools, educational material and support, and presented to over 5,000 advisers during the year.

Marketing

Having a strong and respected brand is critical in order for Challenger to achieve its vision of being recognised as the leader in Australian retirement incomes.

During the year, we launched our new 'retirement on paper' brand campaign. This innovative animation style campaign is designed to further strengthen adviser and consumer brand awareness, whilst also improving the understanding of the benefits annuities can provide as part of the retirement income solution.

The campaign, whilst innovative and designed to cut through, is a call to Google Challenger Annuities, leading consumers to our educational-based website. As a result of the campaign, our online activity has increased significantly, with a more than threefold increase in Challenger's Google search and a 40% increase in Challenger's website traffic.

Challenger's leadership in retirement income education and thought leadership are key drivers in differentiating our brand. Our retirement income research team, led by Jeremy Cooper, continues to play a key role in educating consumers, advisers, media and policy-makers on retirement income issues. During the year, we partnered with Professor Milevsky, a leading global retirement income academic, to produce a series of short videos focusing on important issues such as longevity risk, how much super is needed to fund retirement and retirement income portfolio construction.

The success of the campaign has been externally recognised, winning the 'Advertising Campaign of the Year' at the 2014 Lonsec/Money Management Fund Manager of the Year Awards. The judges applauded our creation of a cut-through campaign, with a memorable message and measurable impact.

The campaign also won the consumer 'Advertising Campaign of the Year' at the Advertising and Sales Excellence Forum and Awards.

Challenger's brand amongst advisers remains very strong. Independent research conducted amongst advisers shows that 89% of advisers recognise Challenger as the Australian leader in retirement incomes. Clients are demanding more information on annuities, with 45% of advisers receiving reverse annuity inquiries from clients.

Challenger's distribution, product and marketing capability remains a core organisational strength. We are committed to ensuring that we remain the leader in retirement incomes, and we will achieve this through diversifying our distribution, continuing our product innovation track record and building a strong and respected brand.



Corporate



**Andrew Tobin and
Blair Beaton**

Chief Financial Officer
and Head of Strategy
and M&A

Andrew Tobin

Chief Financial Officer

Challenger has experienced another successful year, with strong business momentum translating into another year of earnings growth and higher returns for shareholders.

Normalised profit after tax, Challenger's preferred measure of profitability, as it better reflects the underlying operating performance of the business, increased by 7% to \$329 million. Normalised earnings per share increased by even more, up 9% to 64.0 cps, benefiting from higher normalised profits and lower number of shares on issue following the 14 million shares bought back last year.

Challenger is required to value its assets and liabilities supporting the Life business at fair value, despite generally being a hold to maturity investor. This results in positive or negative investment experience and forms part of Challenger's statutory net profit after tax. Investment experience was positive \$12 million (post tax) for the year, with fixed income gains from stability in debt markets partially offset by property transaction costs. Statutory net profit after tax for the year was \$341 million.

Challenger's business is highly scalable, resulting in Challenger being one of Australia's most efficient financial services companies. Over five years, total revenue has increased by 60% whilst expenses have increased by only 10%, resulting in a market-leading cost to income ratio of 35%.

Life's normalised earnings before income tax increased by 6% to \$404 million, with earnings benefiting from AUM growth, a stable margin and our scalable platform. Strong retail annuity sales are helping increase the size of Life's annuity business, which closed the year with \$11.1 billion of investment assets.

Challenger Life held \$903 million of surplus capital above APRA's minimum regulatory requirements at the end of the year, which included an allowance of \$215 million for transition to new capital standards which became effective on 1 January 2013. Life's

capital position, as measured by the prescribed capital ratio of 1.7 times APRA's minimum requirement is above the Board's targeted range of 1.4 to 1.6 times.

Challenger's financial strength was also confirmed during the year by Standard & Poor's, which reaffirmed Challenger Life's 'A' rating with a stable outlook.

Funds Management normalised earnings before income tax increased by 27% to \$43 million. Earnings benefited from an \$11 million increase in fee income, whilst expenses increased by only \$2 million. Fee income increased from higher Funds Under Management (FUM) and higher performance fees. FUM increased by 15% for the year to \$47.1 billion.

Total dividends declared for the year were 26.0 cents per share, representing an increase of 30% on last year. The increase in dividends is due to both higher normalised profits after tax and a higher dividend payout ratio. The payout ratio increased by seven percentage points for the year to 41% of normalised profit after tax. Dividend franking has also recommenced at 40% for the final 2014 dividend.

The Board is focused on increasing shareholder dividends over time, which have doubled over the past five years. The Board has also signalled its intention to increase dividends further in 2015, expecting to increase the payout ratio to a range of 45% to 50% of normalised net profit after tax. Dividend franking is also expected to increase, with the 2015 interim dividend expected to be ~70% franked and the 2015 final dividend ~100% franked. However, the actual dividend payout ratio and franking is subject to prevailing market conditions and capital allocation priorities.

In order to ensure we capture both the structural growth built into the wealth management industry and the new opportunities that may present themselves, we have announced post 30 June 2014 a range of capital initiatives that enable us to support significant growth in the Life business.

In August 2014, we completed a \$250 million institutional equity placement, with shareholders subscribing to additional shares at \$7.53 per share.

We have also undertaken a Share Purchase Plan expected to raise \$30 million, providing retail investors with an opportunity to participate.

In August 2014, we also launched Challenger Capital Notes, which is a debt instrument listed and tradeable on the ASX. Following strong investor demand, the offer is now expected to raise \$360 million.

Challenger's business is growing quickly with significant business momentum and enhanced growth opportunities. We remain confident we can continue executing our strategy whilst increasing returns for our shareholders.

Blair Beaton

Head of Strategy and Mergers and Acquisitions

The Head of Strategy and Mergers and Acquisitions (M&A) reports directly to the Chief Executive Officer, reflecting the integral role that strategy plays in our decision making.

The Strategy and M&A team works closely with both the Chief Executive Officer and the Board to establish the strategic direction of the business. This includes setting strategies to achieve our long-term vision of providing Australians with financial security in retirement. To succeed in this long-term vision, a number of medium-term strategies have been set, including:

- increasing the Australian retirement savings pool allocation to secure and lifetime income products;
- being recognised as the leader in retirement income solutions in Australia; and
- being an active investment manager providing superior returns from platforms with alignment.

Each strategy is supported by specific shorter-term steps that are reviewed annually as part of the strategic planning process.

During 2014, the Strategy and M&A team analysed a series of initiatives, with the following undertaken:

- acquiring Bendzulla Actuarial, the leading provider of SMSF actuarial certificates in Australia;
- merging Challenger's infrastructure investment operations with Access Capital Advisers to create Whitehelm Capital, a new \$4 billion boutique infrastructure business; and
- selling the Howard Mortgage Fund loan portfolio, enabling a more timely return of capital to unitholders and wind-up of the fund.

The Strategy and M&A team will continue to play a key role in ensuring Challenger remains the Australian leader in retirement incomes and our funds management business continues to grow.

Risk and Human Resources



**Angela Murphy and
Richard Willis**

Executive General Manager,
Human Resources
and Chief Risk Officer

Richard Willis

Chief Risk Officer

The Chief Risk Officer is accountable for the implementation of Challenger's Risk Management Framework, which covers all categories of risks. Challenger places a high level of importance on risk management, with the Chief Risk Officer reporting to the Chief Executive Officer.

The Chief Risk Officer also has direct interaction with the Board and Board subcommittees, including the Group Risk and Audit Committee. The Board is fully engaged on all risk matters and treats risk management very seriously. Reflecting this, the Board undertakes dedicated risk workshops to review the Risk Management Framework and to ensure it remains best practice.

Challenger maintains a Risk Management Framework, which ensures all risks are managed and reported across the organisation and remain within the Board's risk appetite. The board's Risk Appetite Statement outlines the level of risk that is acceptable in seeking to achieve Challenger's strategic goals and financial objectives. This has a direct impact on the culture within the organisation and provides clear boundaries on acceptable risk-taking activities across Challenger. Challenger has a strong risk management culture, with employee engagement surveys showing employees take their compliance obligations seriously.

The Chief Risk Officer is also responsible for oversight of regulatory engagement, including APRA and ASIC. Challenger continues to have a positive and productive relationship with APRA and provides a Board-approved Internal Capital Adequacy Assessment Process Report to APRA each year.

APRA is in the process of developing Level 3 capital standards, which were due to be implemented on 1 January 2015. However, in August 2014 APRA deferred a decision on its final standards and implementation until the Government's response to the recommendations of the Financial System Inquiry has been announced.

The Risk and Compliance team plays an important role in supporting Challenger's growth aspirations. During 2014, this has included adapting the Risk Management

Framework to support a number of new initiatives, including the further build-out of Challenger's asset origination capability and execution of a number of Life Risk reinsurance transactions.

Angela Murphy

Executive General Manager, Human Resources

Challenger's culture is core to our success. We continue to invest in attracting and developing a diverse and talented group of people who are engaged in their work and exemplify our principles and culture.

In 2014, we articulated this culture through the development of an employment brand. Employee focus groups confirmed core aspects of working at Challenger that are consistent across the Company.

- We challenge ourselves – we value intellectual inquisitiveness, rigorous analysis and the delivery of results.
- We value each other – we are driven to succeed, and we value and respect each other.
- We offer opportunities – we provide individual development through broad and deep roles and exposure to leaders.
- Employees can make an impact – our vision is bold, and we welcome individual creativity and initiative to achieve it.

Our people strategy is aimed at driving commercial outcomes and enabling sustained success. In addition to our employment brand, key areas of focus in 2014 included:

- Leadership capability and talent development – Challenger has a strong track record of building internal successors and moving leaders and employees across roles. We continue to partner with the Australian Graduate School of Management to deliver leadership programs for our leaders. We also dedicate significant time to reviewing talent across the Company, and designing and implementing plans to further develop the capability and performance of our people.

Risk and Human Resources

- Diversity – Challenger values independent thinking and opinions. We are committed to fostering a workplace in which employees with diverse backgrounds, beliefs, preferences, skills and experiences are able to contribute and succeed. In 2014, we significantly increased the percentage of women in senior management and created a Diversity Committee, chaired by the Chief Financial Officer, to ensure ongoing focus on diversity.
- We also seek to contribute to the growth and sustainability of the communities in which we operate. We have partnered with a range of charitable and not-for-profit organisations which support a broad demographic of Australians including Alzheimer's Australia, Barnardos Australia, Bear Cottage, beyondblue, Meals on Wheels and National Seniors Foundation Trust.

Additional details on Challenger's approach and practices relating to people and sustainability are contained in the Sustainability report, which forms part of Challenger's 2014 Annual Report.



Information for shareholders

Annual General Meeting

All shareholders are invited to attend Challenger's 2014 Annual General Meeting on 28 October 2014.

Full details of the meeting are in your Notice of Meeting and are also available at www.challenger.com.au/share/agm

Key dates

Annual General Meeting – 28 October 2014

2015 interim results – 17 February 2015

Challenger Annual Report 2014

The information contained in this Shareholder Review has been derived from the Challenger 2014 Annual Report. A copy of Challenger's 2014 Annual Report, which includes full details of financial performance is available at www.challenger.com.au/share

If you would like to request a printed copy of the Annual Report, please contact Computershare, Challenger's share registry.

Shareholder queries

If you have any questions about your shareholding, please contact Computershare Investor Services.

Computershare Investor
Services Pty Limited
Level 4, 60 Carrington Street,
Sydney NSW 2000.
Investor queries 1800 780 782
Facsimile +61 2 8234 5050

To assist with all enquiries, please quote your current address and Securityholder Reference Number (SRN) when dealing with Computershare.

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Brian Benari (Managing Director and Chief Executive Officer)
Graham Cubbin
Steven Gregg
Jonathan Grunzweig
Russell Hooper
Brenda Shanahan
JoAnne Stephenson
Leon Zwier

Company secretaries

Michael Vardanega
Andrew Brown

Share register

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