Challenger
Capital Notes
Newsletter February 2018

Peter Polson
Chair

Group assets under management up 18%

$77bn

Life sales

↑21%

Funds Management net flows

$4bn

Regulatory capital above APRA's minimum requirement

$1.3bn

Dear Noteholder,

On behalf of Challenger's Board and management team, I'm pleased to provide you with an update on the performance of Challenger Limited for the first half of the 2018 financial year.

We have started the year strongly, delivering on our strategy which is providing momentum and growth for both our Challenger Life and Funds Management businesses.

Growth in earnings

In our results we are starting to see the benefit of diversification in our distribution channels and product range, which has significantly broadened our customer reach. We are also seeing the benefit of a reweighting to our longer term annuity business, which reduces the rate at which annuities mature and embeds value for shareholders.

Growth in assets under management for the first half was very strong, increasing by 18% on the first half of last year. This drove an 8% increase in normalised net profit before tax[1], and 6% growth in normalised net profit after tax due to a higher effective tax rate.

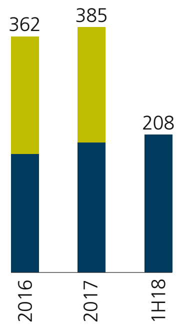
Statutory net profit after tax[1] was $195m and $13m lower than normalised net profit after tax because it includes the impact of valuation changes on Challenger's assets and liabilities.

Normalised earnings were 35.2 cents per share, an increase of 1% on last year with higher earnings offset by a higher share count. The number of shares on issue increased following the $500 million equity placement to MS&AD Insurance Group Holdings Inc. (MS&AD) in August 2017.

MS&AD is the parent company of MS Primary, our distribution partner in Japan. The equity placement was part of a broader strategic relationship, which will increase our access to the Japanese market.

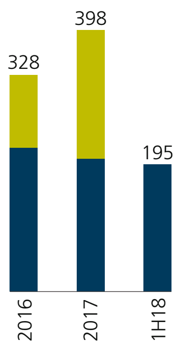
Normalised profit after tax ($m)

up 6%



Statutory profit after tax ($m)

down 3%



1H profit after tax
2H profit after tax

We continue to focus on managing costs and remain one of the most efficient financial services companies. For the first half we achieved our lowest ever cost to income ratio, whilst also investing to capture new distribution opportunities.

Capital management

Challenger is well placed to fund its future growth. Challenger Life's regulatory capital base was $3.9bn and held $1.3bn of excess regulatory capital at 31 December 2017. This represented 1.49 times the minimum level required by the Australian Prudential Regulatory Authority, and is above the mid-point of Challenger's target range of 1.3 times to 1.6 times.

Challenger Life business update

The Life business targets Australia's increasing superannuation savings pool and the rapidly rising number of retirees, with products helping convert savings to regular and reliable income streams.

1 Normalised profit framework and a reconciliation to statutory net profit after tax is disclosed in the Operating and Financial Review Section of the 2018 Challenger Limited Interim Financial Report.

Life sales increased by 21% on last year to $3.3 billion. Annuity sales of $2.3 billion increased by 4%. We continued to focus on longer term business and the average tenor of new annuity sales lengthened to 9.3 years, compared with 8.7 years for the first half of 2017. Sales of other products, including institutional guaranteed products and the recently launched Challenger Index Plus Fund, were very strong and increased by over 80%.

Life continues to broaden its customer reach through expanding its range of products and product features. In September 2017, Challenger's range of annuity products were launched via AMP's adviser portal to their retail and corporate superannuation clients. We are also targeting the launch of Challenger annuities on BT's new innovative Panorama platform in the June 2018 quarter. Following regulatory reform, Challenger launched Australia's first deferred lifetime annuity and is awaiting finalisation of social security means testing treatment for this product.

In Japan, we continue to focus on capturing growth opportunities. MS Primary contributed 17% of first half annuity sales, and we are building on the relationship further with a new Australian dollar lifetime annuity product, which is currently being jointly developed.

Our expanded distribution relationships and product offering, coupled with a focus on long-term business helped increase the size of Life's business, with Life's book growing by 8% for the first half of 2018.

Funds Management business update

The Funds Management business generally targets the retirement savings phase of superannuation by providing investment products aiming to deliver superior investment returns.

Our Funds Management business has a track record of superior long-term investment performance, and with a focus on active investment management continues to attract funds faster than most of the industry[1]. As a result, net flows for the half year were $4 billion, and average funds under management increased by 20%.

Funds Management is capturing the benefits of its increased scale. Growth in net income substantially outpaced expense growth, and as a result, Funds Management earnings before income tax was 31% higher than last year.

Fidante Partners, our boutique investment management business, continues to grow its stable of international boutique fund managers. In February 2018, we announced a new boutique partnership with United States based investment manager, Garelick Capital Partners.

I'm pleased to report Challenger remains strong, is growing and has a clear and focused strategy.

I would like to thank you, our noteholders, for your ongoing support and commitment to Challenger.

Peter Polson
Chairman
Challenger Limited

Additional information section

Manage your holding

For administrative matters in respect of your Challenger holding, please contact Computershare Investor Services.

To assist with all enquiries, please quote your unique Security Reference Number (SRN) and your current address.

T: 1800 780 782

computershare.com/investor

Go electronic

Challenger can deliver your noteholder communications electronically. Please update your communication preferences via Computershare Investor Services. You can also elect to receive your distribution statements via email and all other communications online.

Challenger Capital Notes – Distribution history

Distribution Payment Date	Distribution[2]	Total return[3]
25 May 2017	$0.86	5.1800%
25 August 2017	$0.91	5.1350%
27 November 2017	$0.92	5.1100%
26 February 2018	$0.90	5.1300%

Challenger Capital Notes – Distributions 2018

Ex-date	Record Date	Payment Date
15 February 2018	16 February 2018	26 February 2018
16 May 2018	17 May 2018	25 May 2018
16 August 2018	17 August 2018	27 August 2018
15 November 2018	16 November 2018	26 November 2018

Challenger Capital Notes 2 – Distribution history

Distribution Payment Date	Distribution[2]	Total return[3]
22 August 2017	$1.63	6.1850%
22 November 2017	$1.08	6.1050%
22 February 2018	$1.08	6.1250%

Challenger Capital Notes 2 – Distributions 2018

Ex-date	Record Date	Payment Date
13 February 2018	14 February 2018	22 February 2018
11 May 2018	14 May 2018	22 May 2018
13 August 2018	14 August 2018	22 August 2018
13 November 2018	14 November 2018	22 November 2018

1. Consolidated FUM for Australian fund managers – Rainmaker Roundup September 2017.
2. The Distribution is the cash payment made on each $100 Challenger Capital Note or Challenger Capital Note 2 for the relevant quarterly Distribution Period. It is calculated as the Distribution Rate, multiplied by the number of days in the relevant quarterly Distribution Period divided by 365 days, applied to each $100 Challenger Capital Note or Challenger Capital Note 2.
3. The total return (expressed as a percentage per annum) for each quarterly Distribution Period is equal to the aggregate of the Bank Bill Rate and the Margin of 3.40% for Challenger Capital Notes and 4.40% for Challenger Capital Notes 2. The total return for the relevant quarterly Distribution Period represents (as a percentage per annum) the aggregate of the cash payment and the franking credits.

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