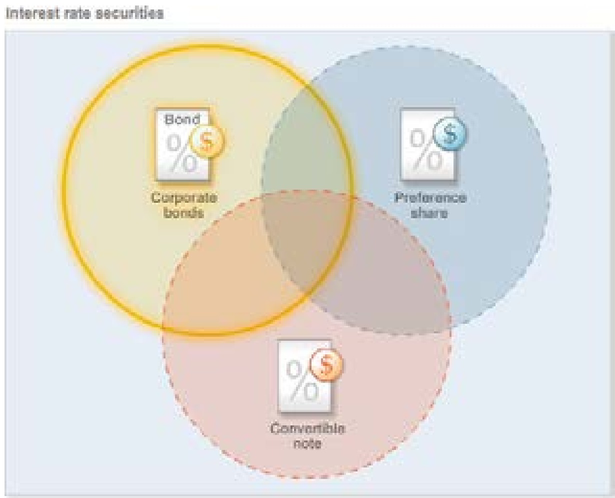
Topic 1: Overview

Three main types of interest rate security are traded on ASX:

- corporate bonds/notes
- preference shares, and
- convertible notes.

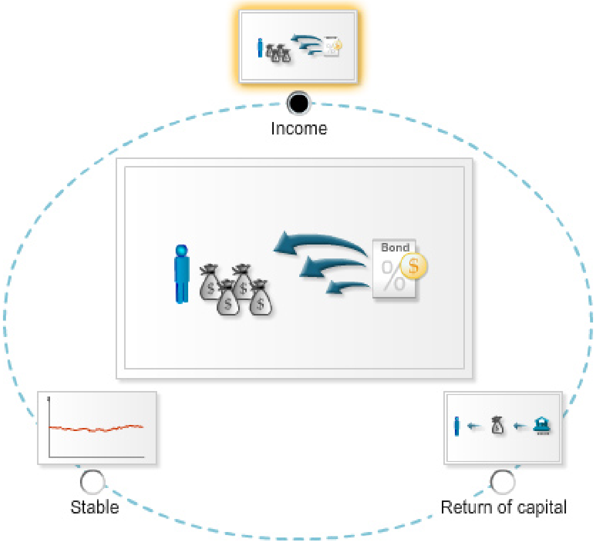


In this course we look at the features, benefits and risks of corporate bonds.

Some issuers have used the term 'notes' (for example 'floating rate notes') to describe securities that are essentially no different to bonds. In this course we will use the term 'bond'.

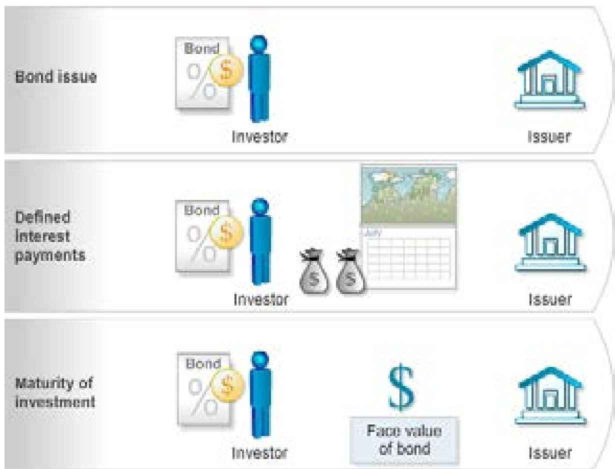
At the end of the course there is a case study of a corporate bond listed on ASX.

Why invest in corporate bonds?



- Bonds pay a defined income, generally at a higher rate than the interest paid on bank deposits.
- The issuer promises to pay the face value of the bond to you in cash at maturity (although some bonds, termed 'perpetual', have no maturity date).
- Bond prices are typically more stable than share prices.

What is a corporate bond?



A corporate bond represents a loan by the investor to the issuing company.

In return, the company pays you interest, which is either a fixed rate, or a floating rate. Floating rates move in line with market interest rates.

At maturity of the bond, the company pays you the bond's face value.

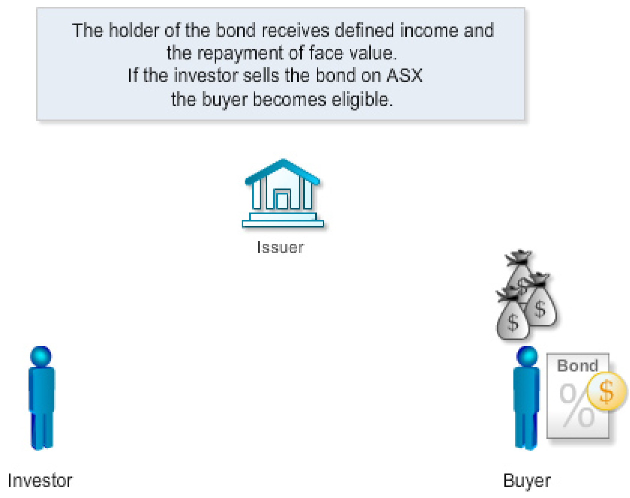
Some bonds are 'perpetual', meaning they have no maturity date. In this case the company pays you interest for as long as you continue to hold the bond.

At the time of issue, you can subscribe for corporate bonds directly from the company - just as you would apply for shares in a float.

Once the issue period is finished, the bonds start trading on ASX.

If you buy a bond on market, you buy from another investor, not from the issuing company.

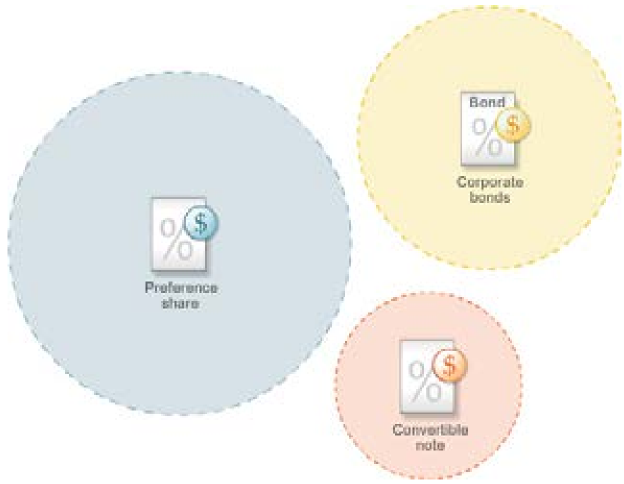
Following an on-market purchase/sale, the bond is transferred from seller to buyer. Even though you did not lend money directly to the issuing company you now have the rights to interest paid on the bond, and the repayment of face value.



The corporate bond market

Three main types of interest rate security are traded on ASX:

- corporate bonds/notes
- preference shares, and
- convertible notes.



Corporate bonds make up around $4.6 billion or 22% of the interest rate security market, the majority of which are floating rate securities (April 2010).

Turnover can be low in some bonds. This may not be important if you plan to hold your bonds to maturity, but you should take it into account if you think you may want to sell on market prior to maturity.

For up-to-date statistics, please refer to the ASX monthly report on trading in the interest rate security market.

Features of a corporate bond

The most important information to know about a bond is:

- interest rate
- whether the rate is fixed or floating
- how often interest is paid
- term to maturity, and
- ranking for repayment in the event of company insolvency.

It is also essential to consider the risk of the company that issues the bond.

The features and risks of corporate bonds are covered in the next three topics of this course.

No two bonds are identical. You should read the prospectus for particular features that may affect the interest you receive, or the repayment of your investment.

Topic 2: Income

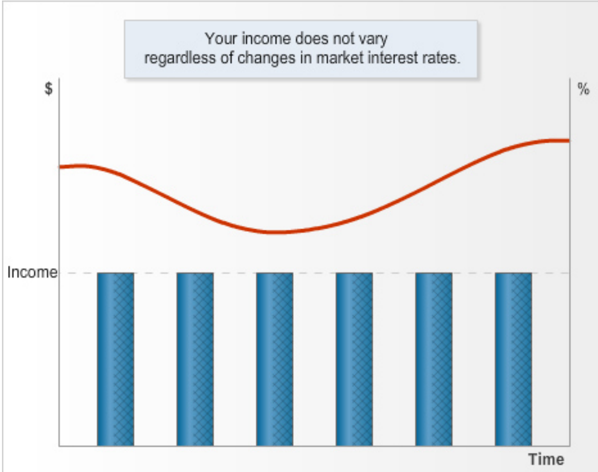
Fixed rate

Some corporate bonds pay a fixed rate of interest, others pay a floating rate.

With a fixed rate your payments do not vary, so you know exactly how much income you will receive.

The interest rate (also called the 'coupon rate') is expressed as a percentage of the bond's face value, and is set by the company at the time of issue.

For example, if a bond has a fixed rate of 7% and a face value of $100, you would receive payments ('coupons') totalling $7 each year.

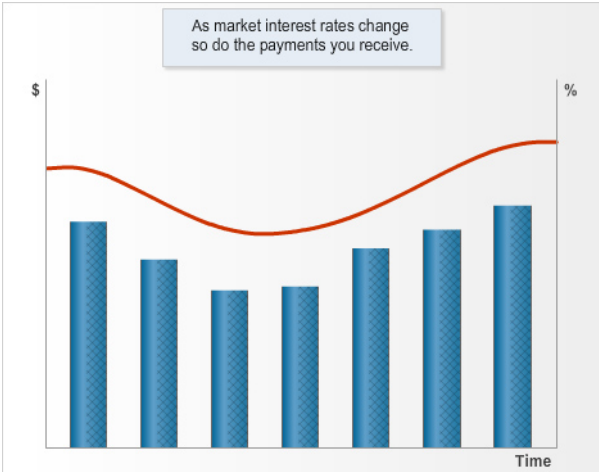


Floating rate

With a floating rate, your payments are linked to a market interest rate.

As the benchmark rate changes, so too do the payments you receive. At regular intervals, typically at the start of each quarter, the payment rate is adjusted to reflect changes in the benchmark rate.

As interest rates rise, your income increases. As rates fall, your income decreases.



Floating rate (continued)

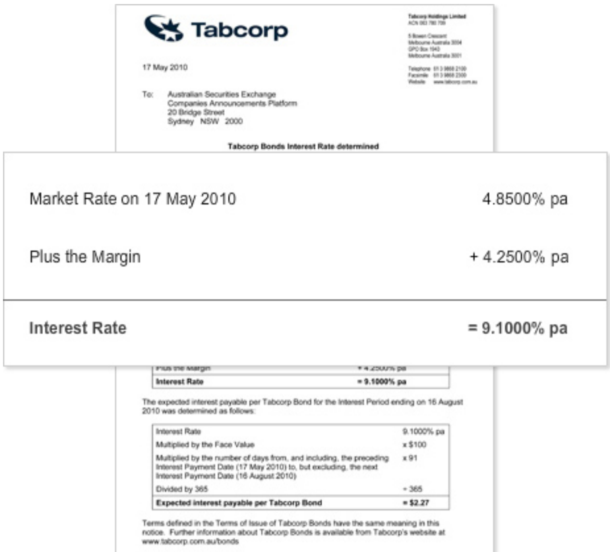
At the time of issue the company specifies:

- the benchmark rate to be used, and
- a margin to be added to the benchmark.

The benchmark plus the margin equals the floating rate for that payment period.

For example, the company might specify payments of 'BBSW+3.0%', meaning:

- the benchmark rate is the Bank Bill Swap rate (BBSW), and
- 3.0% will be added to the BBSW to reach the payment rate.



Tabcorp

17 May 2010

To: Australian Securities Exchange
Companies Announcements Platform
20 Bridge Street
Sydney NSW 2000

Tabcorp Bonds Interest Rate determined

Market Rate on 17 May 2010	4.8500% pa
Plus the Margin	+ 4.2500% pa
Interest Rate	**= 9.1000% pa**

The expected interest payable per Tabcorp Bond for the Interest Period ending on 16 August 2010 was determined as follows:

Interest Rate	9.1000% pa
Multiplied by the Face Value	x $100
Multiplied by the number of days from, and including, the preceding Interest Payment Date (17 May 2010) to, but excluding, the next Interest Payment Date (16 August 2010)	x 91
Divided by 365	÷ 365
Expected interest payable per Tabcorp Bond	**= $2.27**

Terms defined in the Terms of Issue of Tabcorp Bonds have the same meaning in this notice. Further information about Tabcorp Bonds is available from Tabcorp's website at www.tabcorp.com.au/bonds

Fixed or floating?

This is a key investment decision and can make a significant difference to the income you receive.

Interest rates	Fixed rate payments	Floating rate payments
↑	Unchanged	Up
↓	Unchanged	Down

Fixed

The benefit of a fixed rate is you know exactly how much income you will receive.

If interest rates fall, your payments stay the same. If, however, rates rise, you do not receive increased payments.

Investors who are concerned rates will fall might consider buying a bond paying a fixed rate.

Floating

A floating rate means you are exposed to changes in interest rates.

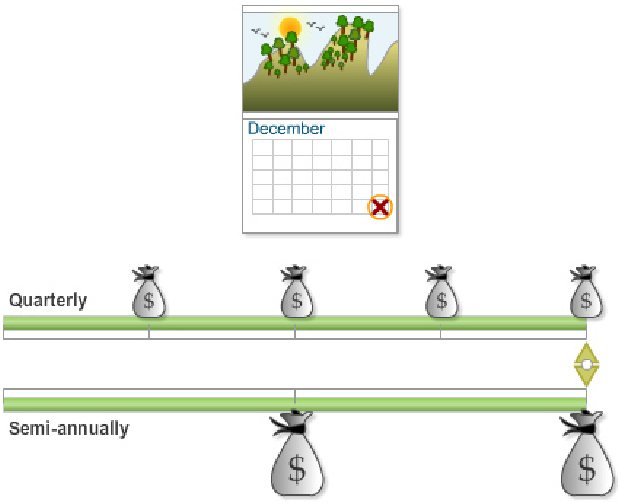
If rates rise, you will benefit from higher payments. If rates fall, your income will be lower.

Investors who think rates will rise might consider buying a bond paying a floating rate.

Frequency of payments

Income is usually paid in arrears either quarterly or semi-annually (twice a year). 'In arrears' means you receive your payment at the end of the period over which the income is earnt.

Generally, the more often you receive income the better. Receiving your income earlier means you can reinvest it sooner to produce more income.



Accrued interest

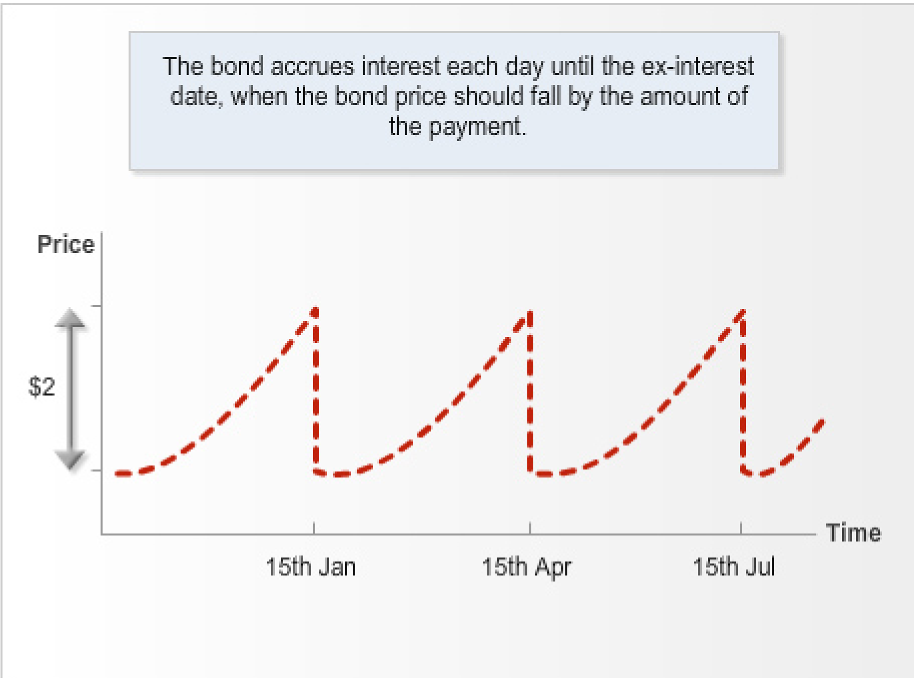
The price of a bond includes the amount of interest that has accumulated since the last interest payment.

Example

A bond with a face value of $100 that pays 8% in quarterly coupons accrues interest at the rate of around 2.2 cents per day (= $8/365 days). The market price of the bond incorporates the accrued interest.

When a bond goes ex-interest, the price of the bond should fall by approximately the amount of the coupon payment. It is now worth $2 less than the day before, as a new buyer will not be entitled to the quarterly payment.

Ex-interest date: To be entitled to the interest payment you must purchase the bond before the ex-interest date. The ex-interest date is generally 4 days before the record date.



Topic 3: Getting your money back

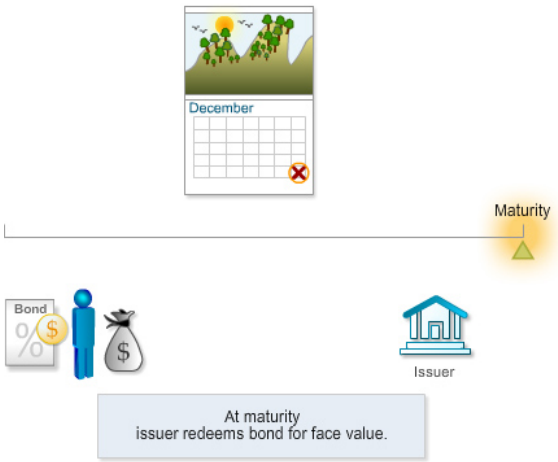
Generally you can get your money back either at maturity or before.

At maturity

If you hold the bond until maturity, the issuer will pay you the face value.

When the issuer pays you the bond's face value, this is called 'redemption'.

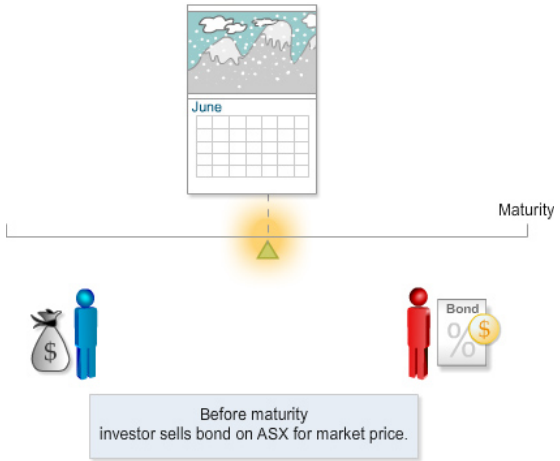
Some bonds give the issuer the right to redeem the bond ahead of maturity. Check the prospectus to see if the issuer has the right to redeem the bond early.



Before maturity

If you want to exit your investment before maturity, you will have to sell on ASX.

There is no guarantee you will receive face value for your bonds when you sell on market. The market price at the time you want to sell may be above or below face value.



Why might a bond's market price be different from its face value?

Change in interest rates

If market interest rates have changed since the time the bond was issued, the bond's price will probably have changed too.

Interest rates		Fixed rate bond	Floating rate bond
↑	Income	Unchanged	Up
	Price	Down	Unchanged
↓	Income	Unchanged	Down
	Price	Up	Unchanged

For bonds paying a fixed coupon, there is an inverse relationship between market interest rates and price:

- as interest rates rise, prices fall, and
- as interest rates fall, prices rise.

Coupon payments do not vary, so the bond price changes when interest rates change.

The price of floating rate bonds is not affected in the same way. Income payments are adjusted when there is a change in interest rates, so the price of the bond generally does not change much.

For a detailed discussion of the relationship between interest rates and bond prices, refer to Course 2.

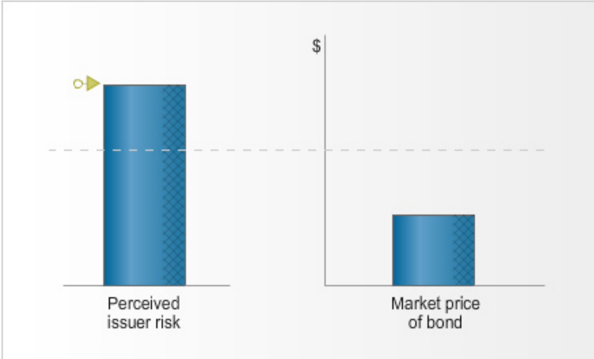
Why might a bond's market price be different from its face value?

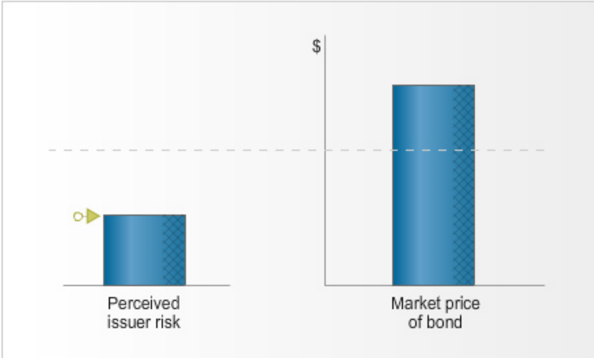
Issuer risk

A bondholder relies on the issuer to make the promised coupon payments, and to repay face value at maturity.

If something happens to change the market's assessment of the risk of the issuer defaulting, the bond's price can change.

For example, a credit rating agency may lower the company's credit rating. If the market thinks there is an increased risk of the company being unable to pay interest, or to repay face value, then the bond's price will fall.





Capital gain/loss on repayment or sale

If you buy your bond at the time of issue and hold until maturity, you will get back the same amount you paid. You make neither a gain nor a loss.

If you buy at issue and sell on ASX, your profit/loss depends on your sale price.

If you buy on ASX and hold until maturity, your profit/loss depends on your purchase price.

If you buy and sell on ASX, your profit/loss depends on both your purchase and your sale price.

Buy	Sell / redeem	Result
At issue	On ASX < face value	Capital loss
On ASX > face value	Hold to maturity	Capital loss
On ASX < face value	On ASX > face value	Capital gain
On ASX < face value	Hold to maturity	Capital gain

Any capital gain/loss you make on sale or redemption of your bond should be taken into account when you consider your overall return from the bond.

	Sale price / redemption value > purchase price	Sale price / redemption value < purchase price
Total return =	Interest payments + capital gain	Interest payments - capital loss

Your total return includes:

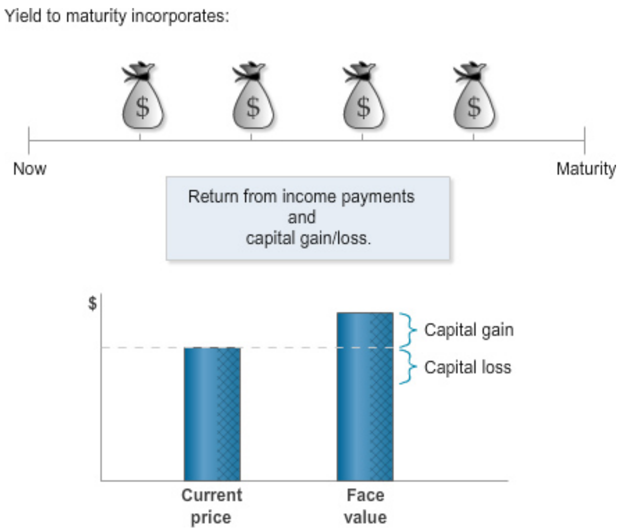
- regular interest payments, and
- any capital gain/loss.

Calculating your return - fixed rate bonds

A bond's 'yield to maturity' captures both income and any capital gain or loss should you hold the bond to maturity.

Calculating yield to maturity enables you to compare bonds with different coupons and different prices. (For more information on yield to maturity, refer to Course 2, 'Income'.)

You can ask your broker for a bond's yield to maturity.



Calculating your return - floating rate bonds

Calculating the return you will make is more difficult if your bond pays a floating rate of interest or has no maturity date. This is because you are uncertain of the size of future payments you will receive.

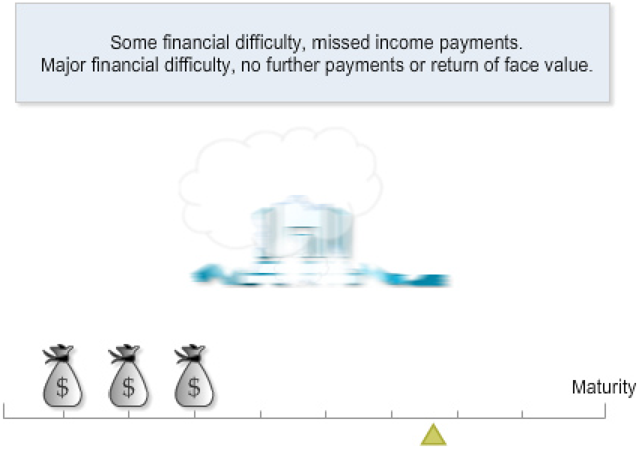
There are two useful measures:

- interest margin: interest being paid above the benchmark rate e.g. BBSW+3.5% - the interest margin is 3.5%.
- trading margin: incorporates the interest margin and the difference between the bond's market price and its face value.

Trading margin is a more complete measure of the returns you will make from a floating rate bond. (This is a measure often used by brokers with expertise in this area.)

Topic 4: Risks

Issuer risk



You expect the company that issued the bonds to:

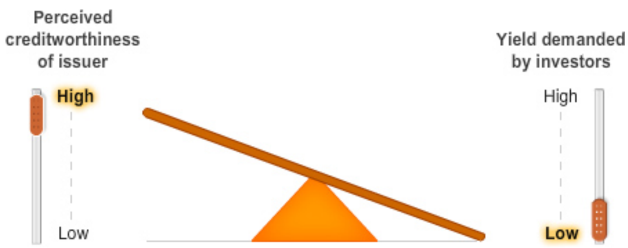
- pay the promised distributions, and
- repay the face value at maturity.

You should research the bond issuer and evaluate its creditworthiness.

If the company is unable to make an interest payment(s), your income will be lower than expected.

If the company goes into liquidation, you may not get all or any of your money back.

Higher return - higher risk



The riskier that investors think a company is, the higher the return they will demand. If you see bonds offering unusually high returns, it may be because the market thinks there is a risk the company will default on its payment obligations.

Conversely, if a company is seen as low risk, it may not have to offer such high returns on its bonds in order to attract investors.

You can compare a bond's yield to a low-risk market rate such as the bank bill rate, or the swap rate for a similar term to maturity. For example, if a bond with three years to maturity has a yield of 9% and the 3-year swap rate is 5%, then the margin over the low-risk rate is 4%.

You should consider whether this margin is a fair reflection of the risk of the bond.

Security and ranking

If the bond issuer goes into liquidation, the likelihood of getting your money back is affected by the bond's security and ranking.

	Ranking and security
1 (highest)	Senior secured
2	Senior unsecured
3	Subordinated unsecured

Security

If a bond is secured by the company's assets, proceeds from the sale of those assets must be used to pay amounts owed to bondholders. Unsecured bonds are not secured by company assets.

Ranking

Ranking is the order in which the company's creditors and investors will be repaid:

- 'Senior' (also termed 'unsubordinated') places you ahead of other creditors with the same security, and ahead of shareholders.
- 'Subordinated' places you behind other creditors, but ahead of shareholders.

The prospectus will tell you the assets the bonds are secured against, and where you rank if the issuer goes into liquidation.

Interest rate risk

This is the risk that your bonds will be affected by an unfavourable movement in market interest rates.

Coupon	Unfavourable movement in interest rates
Fixed	Increase
Floating	Decrease

If your bonds pay a fixed coupon, an increase in market rates means:

- you may receive less income than current market rates, and
- the market price of your bonds may fall, as other investors will find them less attractive than bonds with a higher coupon.

If your bonds pay a floating rate, a rise in interest rates will not hurt you, as the income you receive will also increase. However, if rates fall, your income will decrease.

Risk of capital loss

If you sell your bonds prior to maturity, you will receive the market price. Depending on what you paid for the bonds, you may make a capital loss.

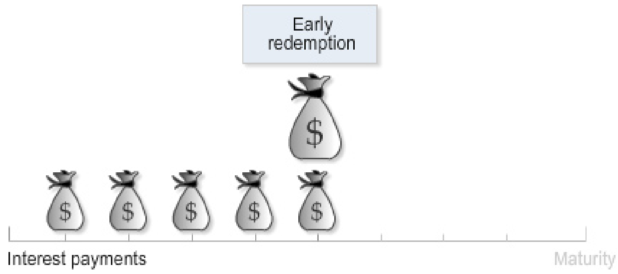
You will also make a capital loss if you buy your bonds on ASX for more than face value, and hold them until maturity.

Buy	Sell / hold to maturity	Capital loss possible?
On market	Hold to maturity	Yes
On market	Sell on market	Yes
At time of issue	Hold to maturity	No
At time of issue	Sell on market	Yes

Early redemption

Some bonds give the issuer the right to redeem before maturity.

The issuer may be able to exercise this right on specified dates, or in specified circumstances, such as a change in control of the company. With some bonds, the issuer has the right to redeem at any time.



Early redemption means you will not receive the income you would have received had the bond continued until maturity. The prospect of early redemption may also affect the bond's market price.

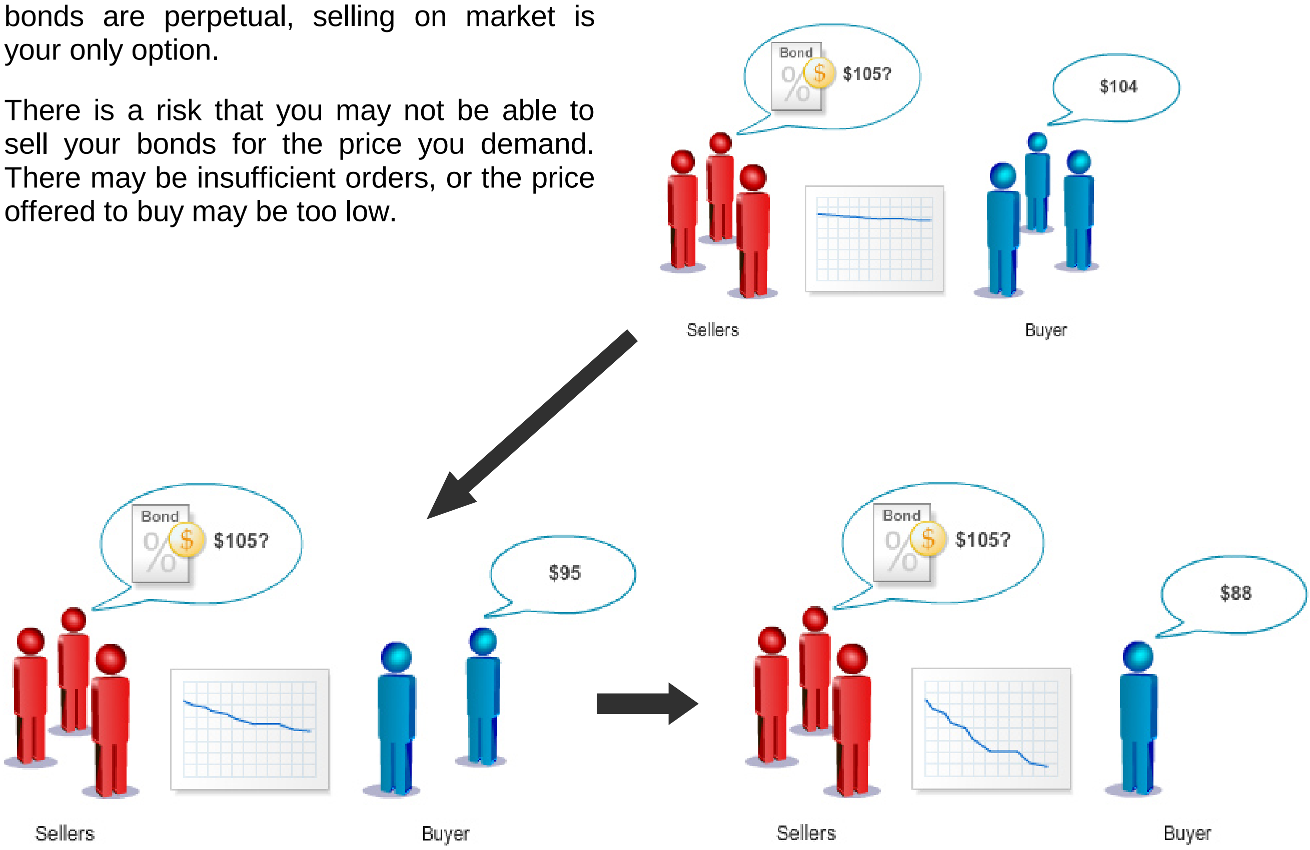
On redemption, you receive face value. This may be less than the market price of the bonds.

The prospectus will state if the issuer has early redemption rights.

Risk of being unable to sell your bonds

If you want to sell your bonds before maturity, you must sell on market. If your bonds are perpetual, selling on market is your only option.

There is a risk that you may not be able to sell your bonds for the price you demand. There may be insufficient orders, or the price offered to buy may be too low.



Topic 5: Case study - Tabcorp bonds

The previous topics have looked at the features, benefits and risks of corporate bonds. Now let's take a look at a bond currently listed on ASX, to illustrate what has been discussed so far.

In March 2009, Tabcorp Holdings Limited announced an issue of corporate bonds. The issue was open to both retail and institutional investors, and aimed to raise around $200 million.

Income

The Tabcorp bonds pay a floating rate of income.

The benchmark rate is the 3-month Bank Bill Rate (BBSW), set on the first day of each interest period.

The margin over the benchmark rate is fixed for the term of the bonds at 4.25%.

A feature of this bond is that an investor who receives at least 100 bonds in the primary issue will be paid bonus interest of 0.25% for the first year if they maintain their holding for that period.

Interest is paid quarterly.

Interest Rate	Tabcorp Bonds will accrue interest in arrears at a variable rate. The Interest Rate for each Interest Period will be the Market Rate on the first Business Day of that Interest Period plus the Margin. See Section 1.5 The first Interest Rate will be calculated on the Settlement Date
Market Rate	The 3-month Bank Bill Rate. See Section 1.5
Margin	The Margin is 4.25% p.a. and will be fixed for the term of the Tabcorp Bonds. See Section 1.5
Bonus Interest	Holders who: • receive an Allocation of at least 100 Tabcorp Bonds; and • continuously hold in their Holding a number of Tabcorp Bonds at least equal to their Allocation until the first anniversary of the Issue Date, will be entitled to Bonus Interest at a rate of 0.25% p.a. on those Tabcorp Bonds until the first anniversary of the Issue Date (up to a maximum of 500 Tabcorp Bonds per Holding). See Sections 1.6 and 7.3
Interest Payment Dates	The Interest Payment Dates are 15 August, 15 November, 15 February and 15 May each year and the Maturity Date and any Redemption Date

Repayment

The term of the bond is five years, with the maturity date 1 May 2014.

At maturity, Tabcorp will pay bondholders the face value of $100, plus the final interest payment.

Tabcorp has rights to redeem the bonds early in limited circumstances. One of these circumstances is a change in tax law relevant to the bonds.

Description	Tabcorp Bonds are five year unsecured debt securities
Issue Price	$100 per Tabcorp Bond
Minimum Application	$5,000 (being 50 Tabcorp Bonds)
Offer size	Tabcorp is seeking to raise approximately $200 million of Tabcorp Bonds. However, it is not a condition of the Offer that Tabcorp receives applications for a minimum number of Tabcorp Bonds or that a minimum amount is raised and Tabcorp has the right to raise more or less than the above amount
Maturity Date	The fifth anniversary of the Issue Date (expected to be 1 May 2014). Tabcorp must redeem all outstanding Tabcorp Bonds on the Maturity Date for $100 cash per Tabcorp Bond and accrued Interest. See Section 1.4

Ranking and security

Tabcorp bonds are unsecured.

The bonds are 'unsubordinated', meaning they rank at least equally with other unsecured and unsubordinated debt obligations of the company.

Ranking	The Tabcorp Bonds rank at least equally with all other unsecured obligations of Tabcorp (other than obligations mandatorily preferred by law) in relation to Interest Payments and the repayment of the Issue Price. Tabcorp's obligations under the Tabcorp Bonds will not be subordinated to any other unsecured debt obligations of Tabcorp (other than those obligations mandatorily preferred by law) – see Section 1.9 It is possible that certain obligations of Tabcorp may rank ahead of the Tabcorp Bonds – see Sections 1.10 and 1.23

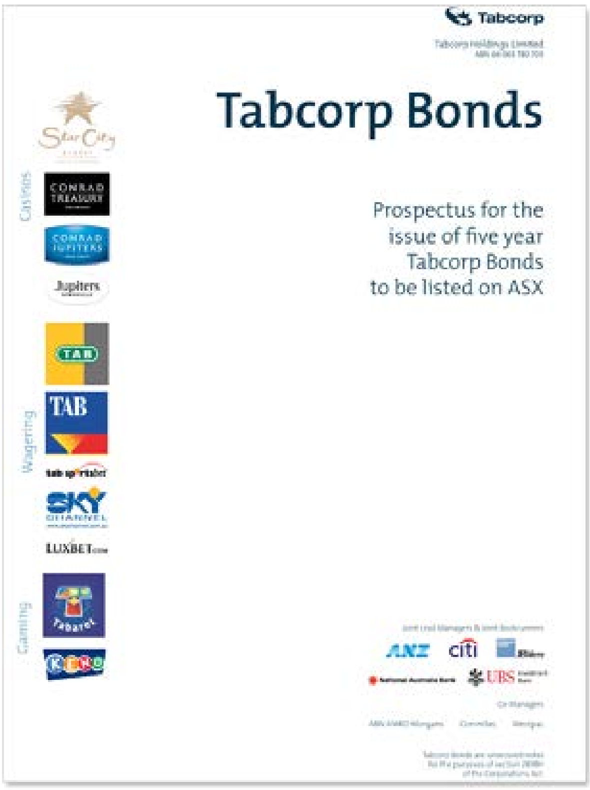
Other features

Other important information includes:

- issue price of $100 per bond
- minimum purchase on issue of $5,000 (50 bonds)
- ASX code the bonds will trade under - TAHHA.

Please note that this table contains summary information of the bond offer. You should always read the full length prospectus for detailed information about any bonds you are interested in.

Tabcorp bonds are trading on ASX. You can check the issuer's website or www.asx.com.au for updated information about this issue.



Summary

A corporate bond represents a loan by the investor to the issuing company.

In return, the company pays you interest, which is either fixed rate, or a variable rate. Interest is paid either twice or four times a year in arrears.

The company also promises to pay you face value at maturity. If you want to sell your bonds before maturity, you can do so on market.

There are two ways of acquiring corporate bonds:

- at the time of issue, by subscribing directly to the company
- after the primary issue period is finished, by buying on ASX.

A bond's market price may be different from its face value.

Consequently, you may make a capital gain or loss if you either buy or sell a corporate bond on the secondary market (ASX).

Your total return from a bond includes:

- regular interest payments, and
- any capital gain/loss.

The main risks of corporate bonds are:

- the issuer may be unable to pay the promised interest, or to repay face value at maturity, and
- interest rates may move unfavourably.