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# Module One:

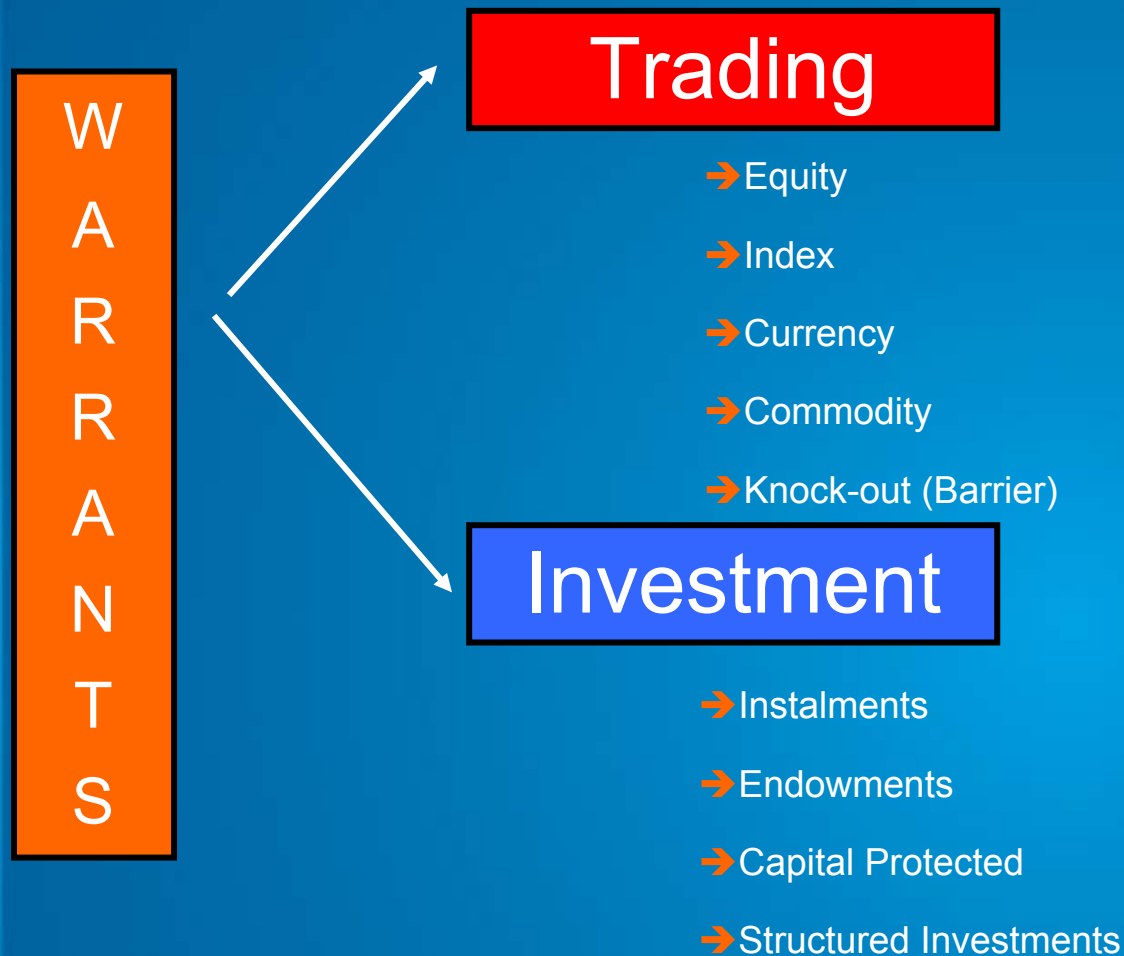
## The Basic Mechanics of ASX Quoted Instalments

# Disclaimer:

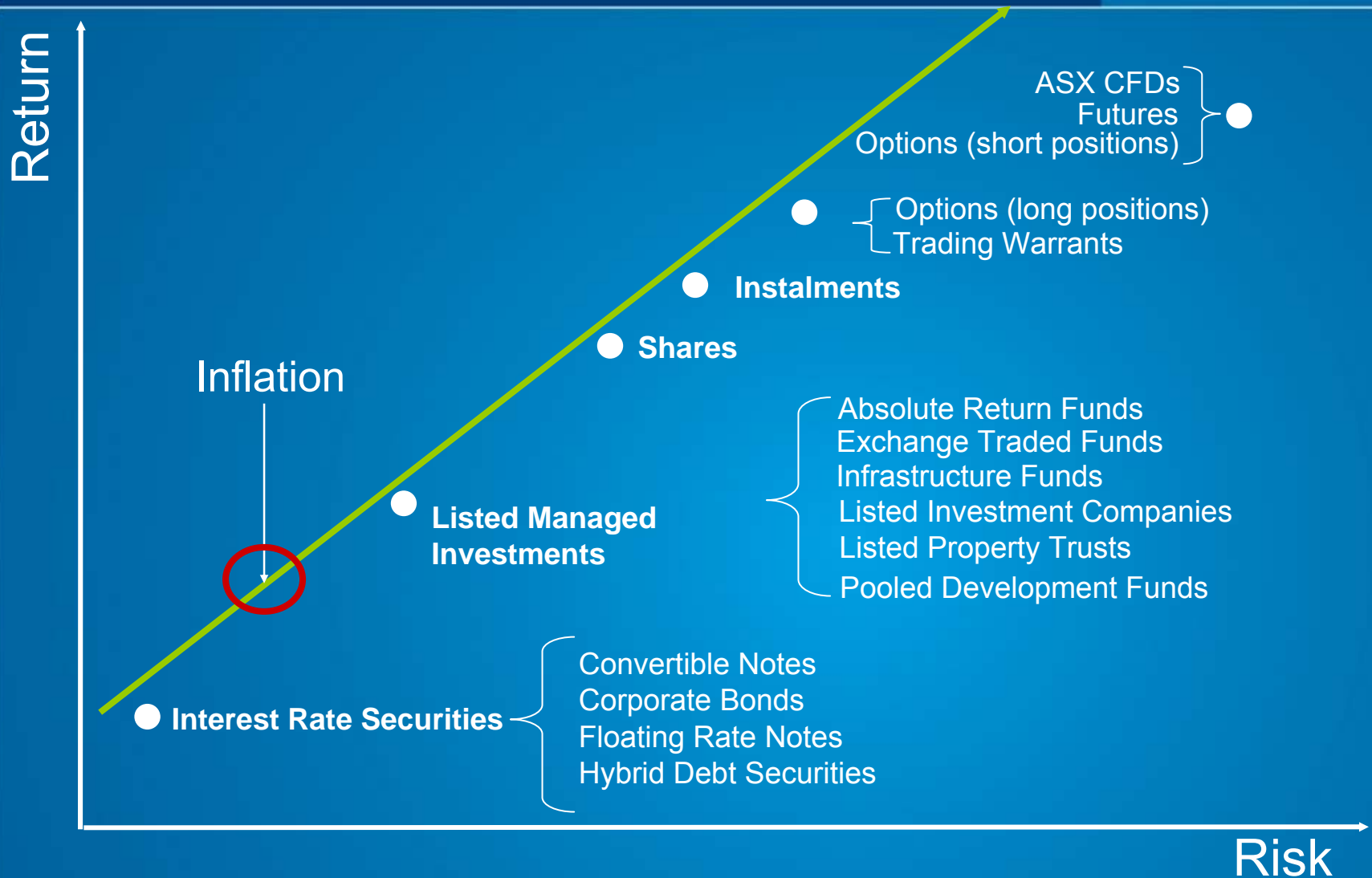
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# Types of ASX Warrants



# The ASX Product Suite



# Lecture Series Modules



## Upcoming presentations – key dates

		2008						
		FEB	MAR	APR	MAY	JUN	JUL	AUG
Module	Topic							
1	Basic Mechanics of Instalments	✓						
2	Instalment Strategies: Cash Extraction		✓					
3	Instalment Strategies: A leveraged yield (DYP)			✓				
4	Course in review: Instalments and the Instalment buy-write					✓		

Register online [www.asx.com.au/warrants](http://www.asx.com.au/warrants)

# Module One Agenda

- ASX Quoted Instalments structure
- How to identify an Instalment
- Small capital outlay examples (Leverage & Diversification)
- Investing in Instalments (ways to buy & sell)
- Benefits and Risks



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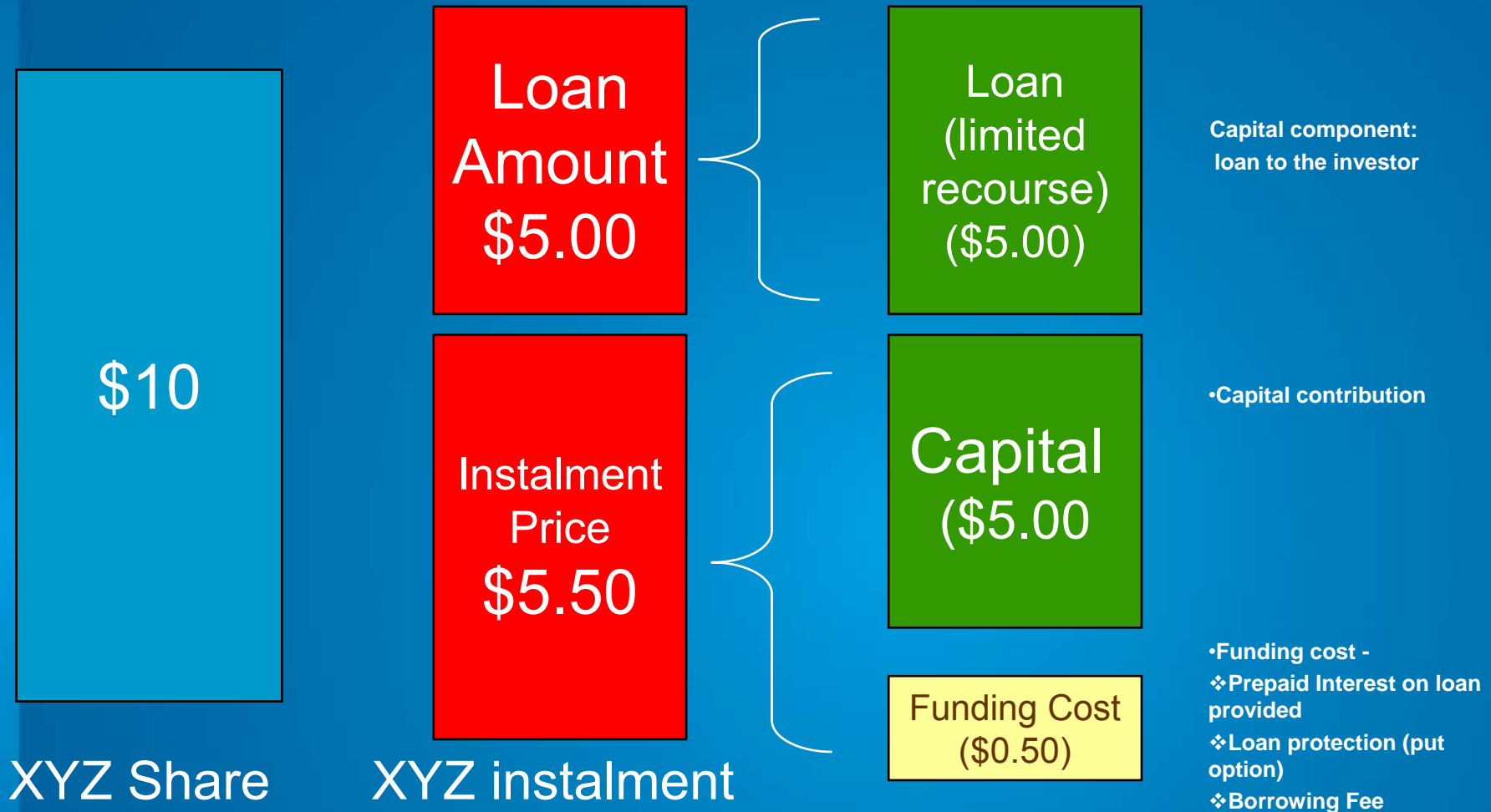
# ASX Quoted Instalment Structure

# What is an Instalment?

- Instalments allow full exposure to a share with **part payment now** and an **optional final payment later**
- Entitlement to all dividends, distributions and franking credits similar to share ownership
- Similar to Telstra instalment receipts
- Generally issued between 1 to 15 years by a financial institution
- Tradable on-market (ASX) through your broker
- Eligible form of gearing for Self Managed Super Funds (SMSF)



# Pricing an Instalment



# Scenarios - share price movements



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- What MAY happen when purchasing an instalment.
- XYZ is \$10
- XYZIMM
- Instalment value \$5.50
  - (inc \$0.50 funding cost)
- Loan amount \$5.00

\$10.00

XYZ Share

Loan  
Amount  
\$5.00

Instalment  
Price  
\$5.50

XYZIMM

# Scenarios - share price rise

- At maturity the share price is \$20
- Instalment now valued at \$15
- Loan amount remains \$5.00
- The instalment's loan amount is fixed, therefore the value of the instalment will increase by the same amount (minus the decay of the funding cost) in absolute terms.

\$20.00

XYZ Share

Loan  
Amount  
\$5.00

Instalment  
Price  
\$15.00

XYZIMM

# Scenarios - share price flat

- At Maturity the share price is unchanged
- Instalment value remains \$5.00
- Loan amount remains \$5.00
- No Margin Call
- Funding decay occurs
  - Prepaid interest
  - Borrowing fees
- The funding decay may be claimed as an interest deduction.

\$10.00

XYZ Share

Loan  
Amount  
\$5.00

Instalment  
Price  
\$5.00

XYZIMM

# Scenarios - share price falls

- **If the share price is \$2 at maturity**

- Instalment valued at \$0.00
- Loan amount remains \$5.00

No recourse	\$3.00	Loan Amount \$5.00
XYZ Share	\$2.00	

- No Margin Call
- The loan amount is a limited recourse loan.
- No obligation to repay the loan amount, irrespective of the share price performance (up, down, or sideways).
- You walk away with a capital loss and claim the funding cost as a tax deduction.

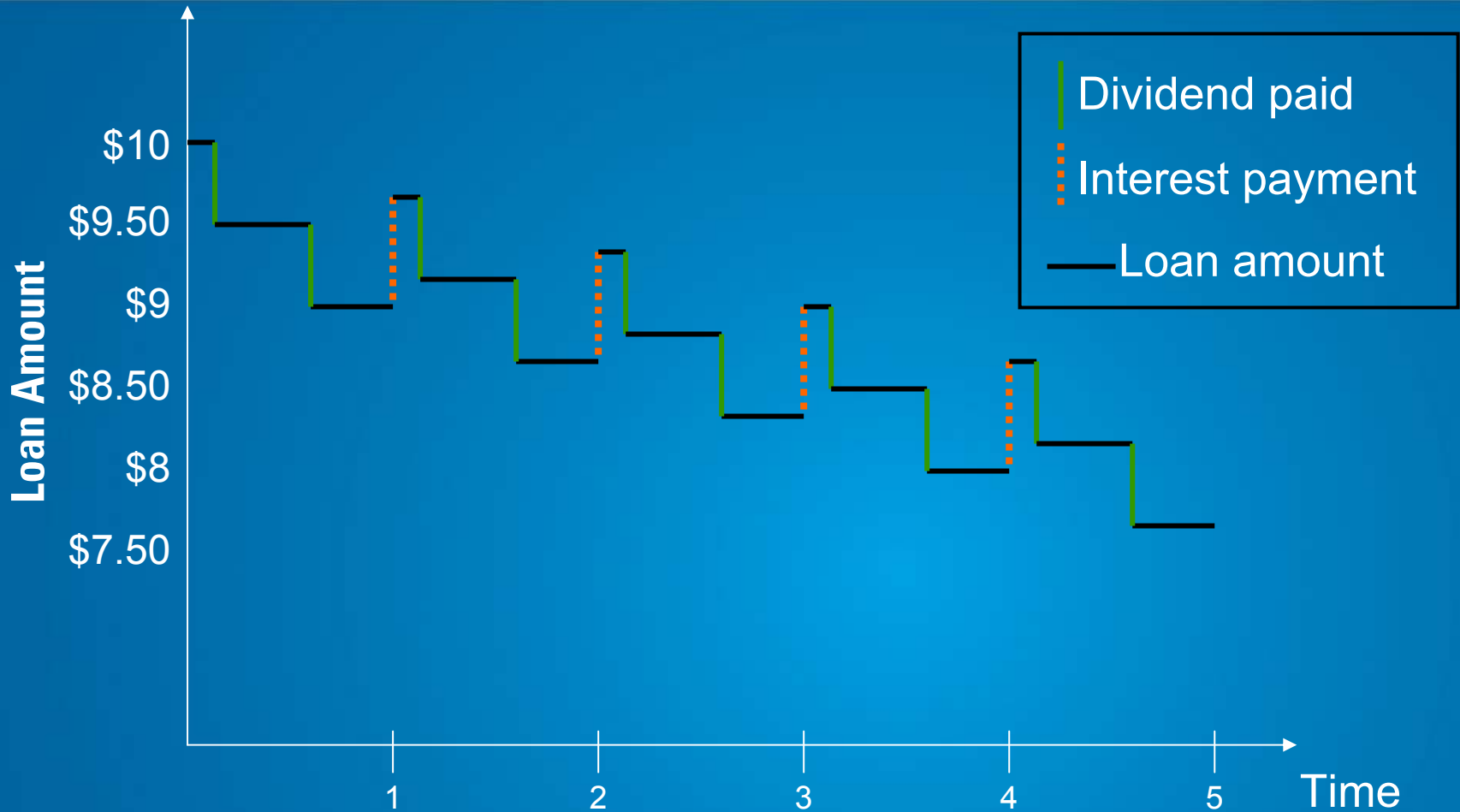
- Please note that in each scenario the example has been assumed to be at expiry. At any time you are able to sell the instalment on market, crystallising a profit or loss.

# Types of Quoted Instalments

- **Self Funding Instalments (SFI)**

- Tend to be moderately geared with an investment term between 5 and 10 years.
- Post the initial payment, generally, there are no additional payments required during the investment term.
- SFI holders enjoy a vested right to all entitlements however the cash component of a dividend is used to reduce the loan amount rather than being paid in cash.
- The loan amount increases once every 12 months as funding costs are added to the total loan amount.
- Over the life of the SFI, the loan amount can periodically decrease due to the payment of dividends and increase by the amount of funding costs.

# How SFIs Work?



# Types of Quoted Instalments

- **Rolling Instalments**
  - On the Reset Date
    - the Instalment Payment for the Loan Amount is reset for the next period.
- **Income Instalments**
  - Prepay up to 12 months of interest on investing with the remaining interest portion added to the loan amount at one or more later dates.
- **Dividend Advance**
  - Up to 75% of the estimated dividend paid upfront to the investor
    - Allows further leverage

# Gearing of an Instalment (LVR)

- Definition: Loan / Share Price (Loan-to-Value Ratio)
- Instalments are issued with different gearing levels
  - Regular geared – 40-65%
  - Highly geared – 65-110%
- Gearing of an Instalment is not constant
- ‘Regular Geared’ can become ‘Highly Geared’ and vice versa



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# Regular v Highly Geared Instalments

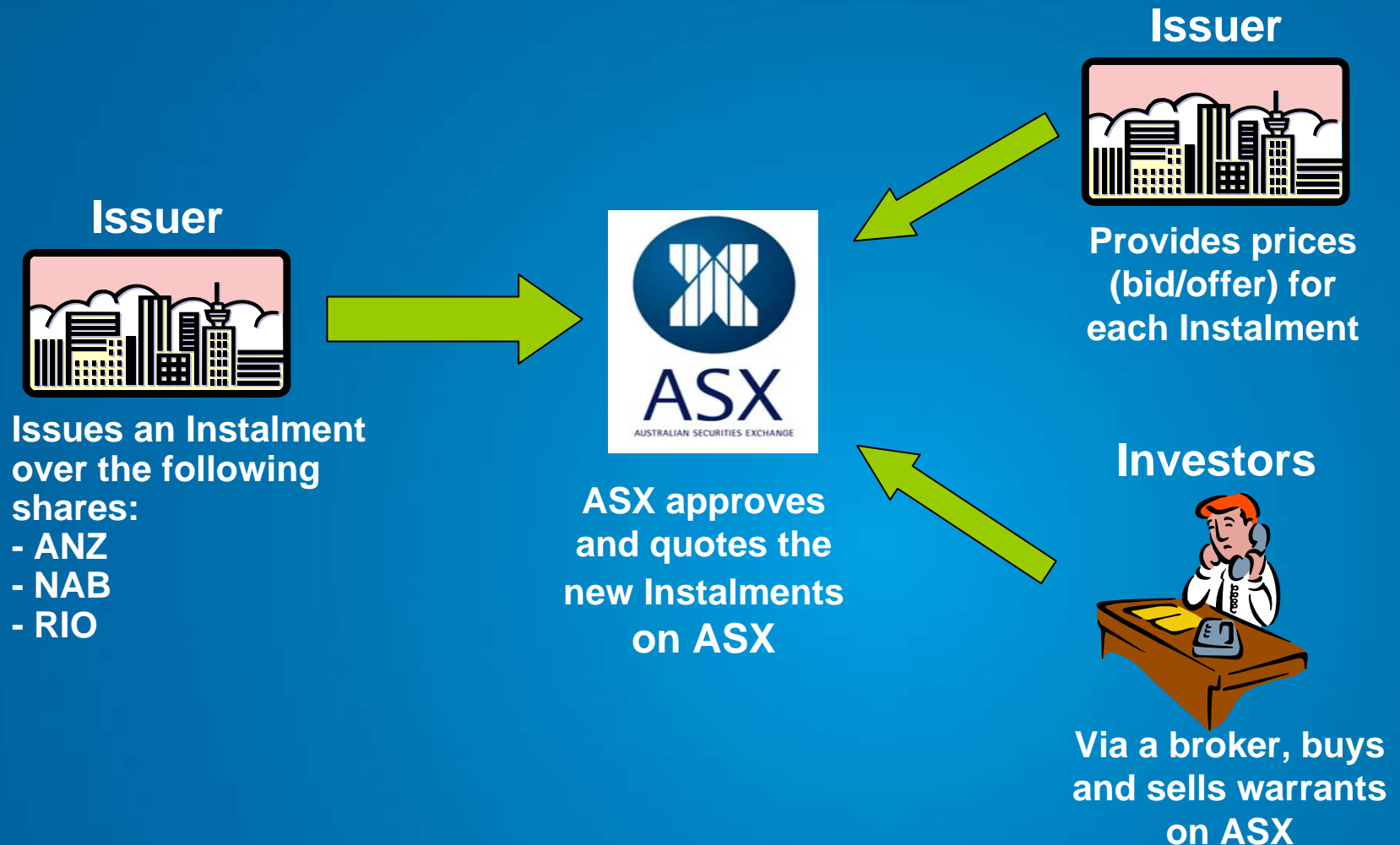
## Investment

- Gearing level - 40-65%
- Medium risk/reward
- 12 – 36 months
- Med. – Long term instrument (investors)
- Preferred strategies
  - Portfolio construction
  - Div Yield Play  
(DYP Module 3)
  - Call Option Writing

## Trading

- Gearing Level - 65-100%
- Med./High Risk/Reward
- 12- 24 months
- Short term instrument (traders)
- Preferred strategies
  - Div Yield Play  
(DYP Module 3)
  - Short-Term price movements

# Instalments on market



# Trading Practices - Buy

- Secondary Market
  - Through a broker / Financial planner
- Primary Market
  - Cash payment
  - Rolling over
  - Lodging of stock – Share holder application

# Trading Practices – Sell/Exercise

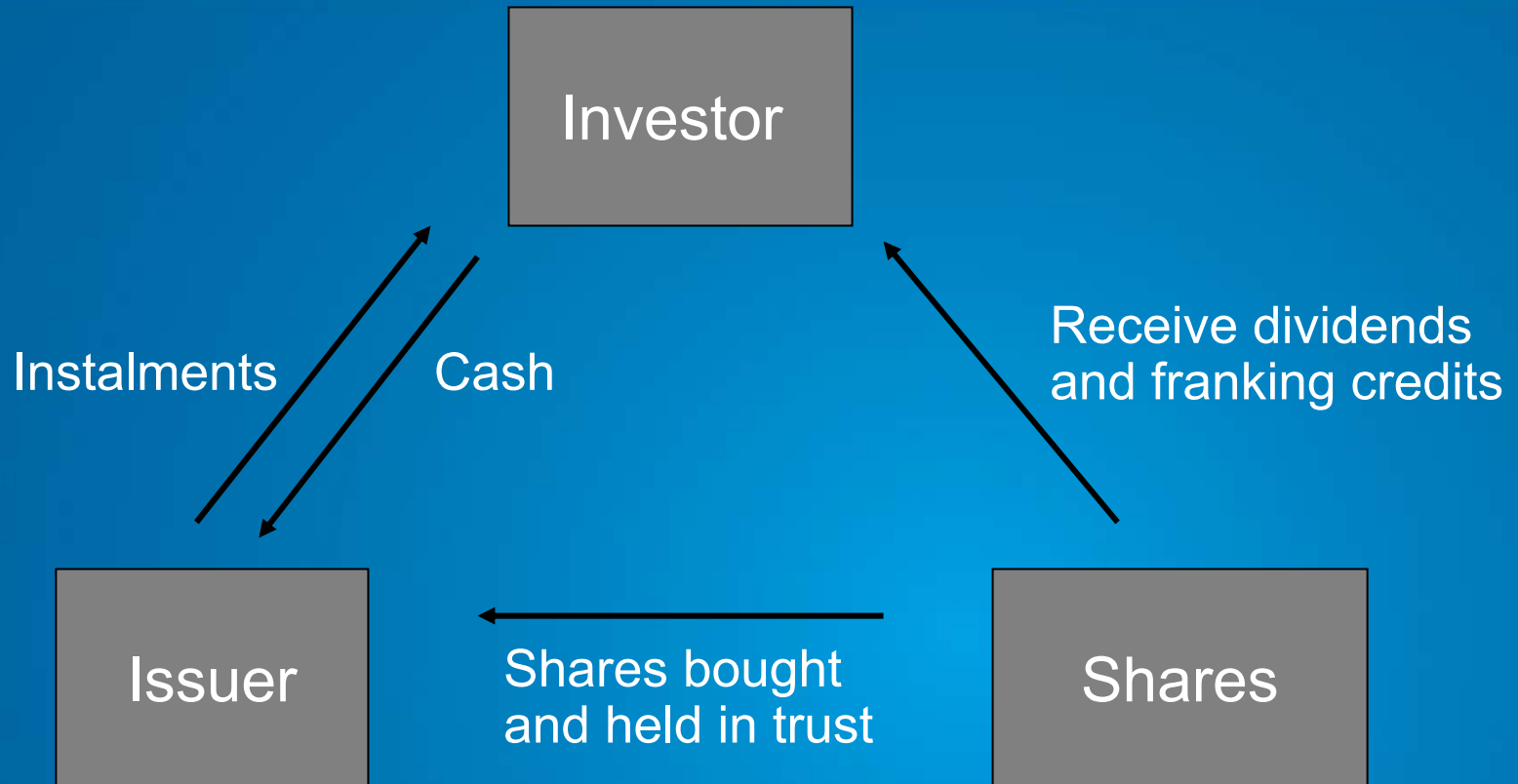


- Secondary Market
  - You can sell your warrants through a broker at anytime the market is open (just like shares).
- Primary Market
  - Exercise and pay the second payment
  - Wait until after the expiry date and do nothing; Issuer will auto exercise (AVP Rule)
  - Rolling over

# Buying Primary Market Instalments



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# How to identify an Instalment

# Instalment Coding: BHPIZQ



Warrants Markets								
TRADED POSITIONS FOR WEDNESDAY, JULY								
ASX CODE	Ex Price	Expiry Date	Conv Ratio	Bid	Ask	Last Sale	Chg +/-	Vol 100s
<b>Equity Call Warrants</b>								
<b>Aust Gas Light Last Sale Price \$17.47</b>								
AGLWMC	18.00	21/12/06	4:1	.305	.31	.315	-0.5	200
<b>Aristocrat Leisure Last Sale Price \$12.80</b>								
ALLWOG	14.00	27/07/06	4:1	-	-	.088	-21.2	38
<b>AMP Ltd Last Sale Price \$9.13</b>								
AMPXMJ	7.49	27/07/06	.96:1	1.815	1.845	1.90	+35	50
AMPXOF	8.00	28/09/06	1:1	-	-	1.45	+8.5	400
AMPWMB	9.10	26/10/06	3:1	.21	.22	.22	-0.5	740
<b>ANZ Banking Grp Last Sale Price \$26.78</b>								
ANZXMB	23.94	27/07/06	1:1	2.96	3.22	2.86	-5	20
ANZWOE	25.50	27/07/06	4:1	-	.46	.38	+4	30
ANZWOF	27.00	27/07/06	4:1	-	-	.155	+1.5	50
ANZWMF	28.50	27/07/06	5:1	.006	.03	.012	+0.2	400
ANZXOH	24.00	28/09/06	1:1	-	-	3.36	-19	100
ANZWOH	26.00	28/09/06	4:1	-	.50	.485	+0.5	600
ANZWMG	27.00	28/09/06	5:1	.235	.245	.245	+2.5	310
<b>Alumina Ltd Last Sale Price \$7.08</b>								
AWCWMJ	7.50	28/09/06	3:1	.12	.13	.125	+1	1450
AWCXMG	6.00	26/10/06	1:1	1.295	1.325	1.38	-	1000
<b>BHP Billiton Ltd Last Sale Price \$28.80</b>								
BHPVOO	27.00	27/07/06	4:1	-	.90	.56	-6	168
BHPWMI	28.00	27/07/06	4:1	.385	.395	.41	-7	446
BHPVOA	29.00	27/07/06	4:1	-	-	.245	-6.5	8730
BHPWON	30.00	27/07/06	4:1	.135	.17	.135	-4.5	3134
BHPVOB	31.00	27/07/06	4:1	.08	-	.083	-4.2	1120
BHPVOC	32.00	27/07/06	4:1	-	.062	.056	-1.9	805
BHPXO4	22.00	24/09/06	4:1	-	-	7.50	+1.0	100

“BHP” identifies the underlying security

“I” the 4<sup>th</sup> letter indicates the type of warrant

I or J = instalment,

E = endowment,

X or Y = exotic,

S = structured investments & SFI

W or V = trading

“Z” the 5<sup>th</sup> letter identifies the issuer e.g. Z = ABN Amro

“Q” the 6<sup>th</sup> letter identifies each series



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# Leverage & Diversification

# Leverage

➤ Instalments can leverage your investment – initial investment of \$40,000 = \$ 76,367 of share exposure

Stock	Shares		Instalment	
	Price	Quantity	Price	Quantity
BHP	\$39.75	251	\$19.59	510
CBA	\$51.80	193	\$26.59	376
QBE	\$29.35	340	\$16.34	611
WOW	\$29.15	343	\$15.59	641
<b>Total Invested</b>		<b>\$39,932</b>		<b>\$39,938</b>



**\$76,367**

# Diversification

- Instalments can help diversify your investment – gain share exposure at a fraction of the price by investing the equivalent number of instalments as shares purchased.

Stock	Shares		Instalment	
	Price	Quantity	Price	Quantity
BHP	\$39.75	251	\$19.59	251
CBA	\$51.80	233	\$33.16	233
QBE	\$29.35	340	\$16.34	340
WOW	\$29.15	343	\$15.59	343
<b>Total Invested</b>		<b>\$39,927</b>		<b>\$23,546</b>

- Remaining funds \$16,380 can be used to invest in other assets (instalments, other shares, property etc).



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# Investing in Instalments (ways to buy & sell)

# An overview of the mechanics

When you purchase an ASX Instalment, the Issuer purchases the underlying share and holds it in trust in your name.



## 3 Ways to Purchase

- On the ASX
- Off market using a cash application form (primary app.)
- “Converting” your shares into instalment warrants using the security holder application form (cash extraction)

## During the life of the investment

- You are entitled to dividends and franking credits.
- The prepaid interest component *may* be taken off of your income to help reduce your tax bill.
- The value of the instalment moves due to fluctuations of the share price.

## 4 choices at Completion

- Take delivery of the share by paying the final instalment (= a fixed amount). No CGT triggered.
- Opt to take cash settlement (= share price less the final instalment) and pay CGT.
- Roll your instalments into a new series. No CGT triggered.
- Do Nothing

NB Should the share price be below the final instalment, you have no obligation to pay the final instalment.



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# Benefits and Risks

# Benefits of Instalments

## Compared to a direct share investment Instalments offer:

- Smaller initial outlays
- Known and limited downside risk – first Instalment
- Higher potential returns
- Higher dividend income and yield (compared to shares)
  - Excess Franking Credits are refundable for SMSFs
- Potential taxation benefits
  - Interest Expense

# Risks of Instalments

- Instalments offer a greater level of leverage compared to the underlying securities.
  - Risk management is essential
  - The higher the level of gearing the higher the risk
  - The possibility that the interest costs may be higher than the investment returns
- Understanding the product is the key to success – gearing, relationship to underlying, dividends.
- The liquidity of Instalments is governed by the liquidity of it's underlying not the number of Instalments traded.

# Why invest in Instalments?

- Generate wealth with a limited capital base
- Receive a regular and reliable income stream
- Safer gearing solution – No Margin calls
- Known and limited downside risk – first instalment
- Tax effective
- Eligible form of gearing for SMSFs

# Module 1 – wrap up

What have we covered?

- Instalment structure
- Types of Instalments available on ASX
- How to identify a warrant
- Positives and negatives of leverage
- Eligible form of gearing for SMSFs

# ASX information



- **[www.asx.com.au/warrants](http://www.asx.com.au/warrants)**
- Fact Sheets
  - Investment strategies using instalments
  - Trading strategies using instalments
  - Short-term trading using Trading-Style Warrants
  - Issuer Contact List
- Brochure
  - Understanding Trading & Investment Warrants
- Enquiries:
  - E-mail **[info@asx.com.au](mailto:info@asx.com.au)**
  - ASX customer service on 131 279

# Module Two

## Instalment Strategies: Cash Extraction (March 2008)



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