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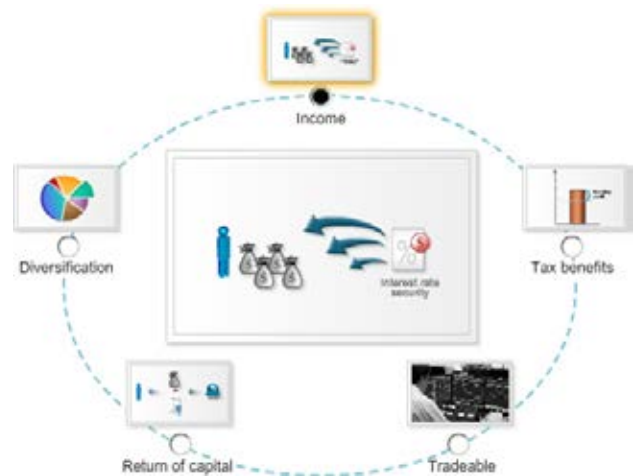
Topic 1: Why invest in interest rate securities?

Interest rate securities appeal to investors looking for a regular and reliable income stream.

Many interest rate securities also offer benefits not available from traditional interest-paying investments such as term deposits.

Interest rate securities:

- pay a defined income stream
- generally return their face value at maturity
- enable you to diversify your investments
- are bought and sold on ASX
- may offer tax advantages.

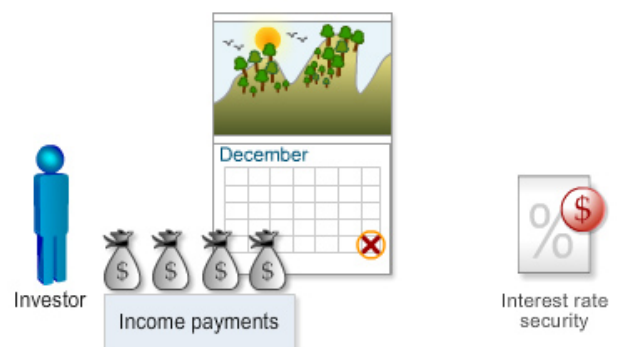


Defined income

All interest rate securities pay you income.

Your income may be paid once, twice or four times a year.

Income from interest rate securities is typically higher than interest paid on bank deposits.



Return of capital

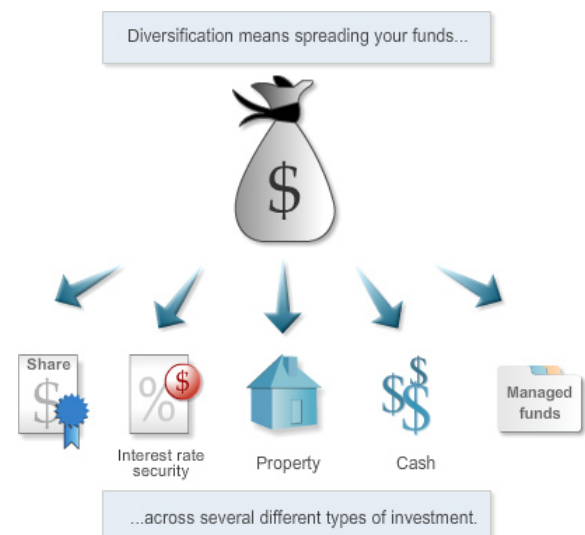
At the maturity of your investment, the issuer of the interest rate security typically promises to return the face value of the security to you.

Many interest rate securities pay you the face value of the security in cash.

Some, however, pay you in the form of shares. These securities are called 'convertible' or 'converting' as they convert into shares.

Diversification

Diversification is a fundamental principle of wise investing. You can reduce your overall risk by spreading your funds across several classes of investments, and across different investments within each class.



Although interest rate securities are listed on the sharemarket, their performance is typically not correlated with the performance of shares. They may hold their value when share prices are falling, while at other times shares may outperform interest rate securities.

Traded on ASX

ASX interest rate securities are listed and traded on ASX. You buy and sell through your broker, just as you buy and sell ordinary shares.

This makes it simple to sell all or part of your investment at short notice, or to add to it. Compare this to a term deposit held at a bank, where you are locked in for a fixed period of time, making access to your funds difficult.

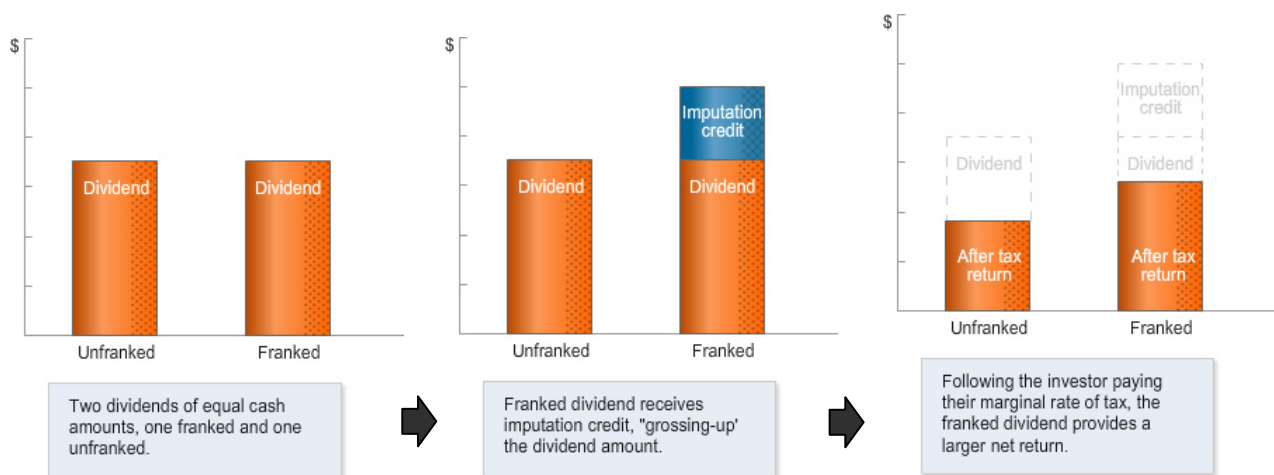
Tax advantages

There may be tax benefits from investing in interest rate securities.

Income from an interest rate security may be paid as:

- interest, or
- dividends.

If paid as a dividend, there may be franking credits (imputation credits) attached, which can be used to offset tax on your earnings.



Topic 2: What are interest rate securities?

An income-producing loan

Companies issue interest rate securities to raise money.

At the time of issue, you can subscribe for interest rate securities directly from the company - just as you would apply for shares in a float. This is called buying on the primary market.

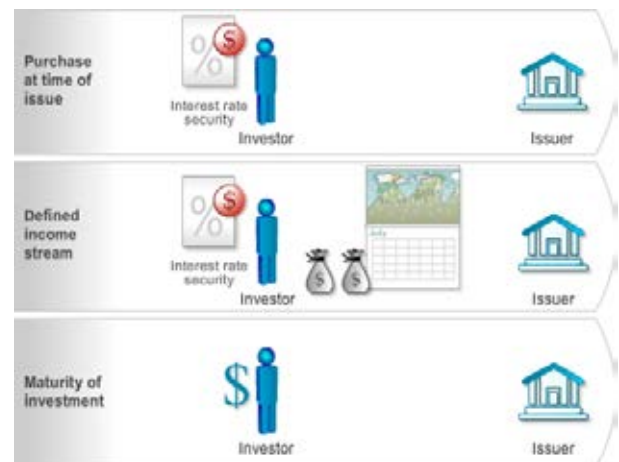
When you buy on the primary market, you are lending money to the company that issues the security.

In return, you have the right to receive a defined distribution in the form of interest, or as a dividend. In most cases the issuer promises to repay you the face value of the security at a specified future time.

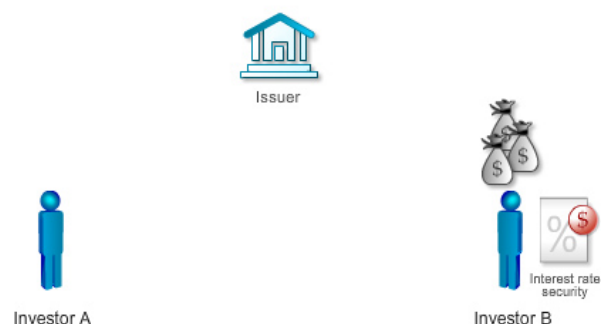
Once the primary issue period is finished, the interest rate securities start trading on ASX (the secondary market).

If you buy the interest rate security on ASX, you buy from another investor, not from the issuing company.

Following an on-market purchase/sale, the interest rate security is transferred from seller to buyer. Even though you did not lend money directly to the issuing company you are now eligible for the income paid on the security, and the repayment of face value.



The holder of the interest rate security receives defined income and the repayment of face value. If the investor sells the security on ASX the buyer becomes eligible.



Debt capital vs. equity capital

It is important at this point to distinguish between equity capital and debt capital.

An ordinary shareholder has equity capital in the company. Your shares represent ownership of a part of the company - a part of its assets, liabilities and earnings.

Someone who lends money to a company has debt capital. You become a creditor, owed money by the company, but do not own part of it.

Some interest rate securities sit entirely in the category of debt capital.

Equity capital	Debt capital
Owns part of company	Creditor
Shareholder	Lends money to company

Others, known as hybrids, offer the possibility of conversion into shares, and have features of both debt and equity.

Debt capital vs. equity capital (continued)

Why does the distinction between equity and debt matter?

Shareholders and creditors are treated differently when it comes to the payment of income, and in the event the company goes into liquidation.

The payment of interest to creditors has priority over the payment of dividends to shareholders, and the repayment of debt ranks before payments to shareholders if the company is wound up.

In later modules we will look at how you should take these factors into account when you are considering an investment in an interest rate security.

Buy direct from issuer or on ASX

There are two ways to buy interest rate securities.

You can buy directly from the issuer, before on-market trading starts. This process is similar to subscribing for shares when a company is floated. The issuer produces a prospectus, which includes an application form for new securities.

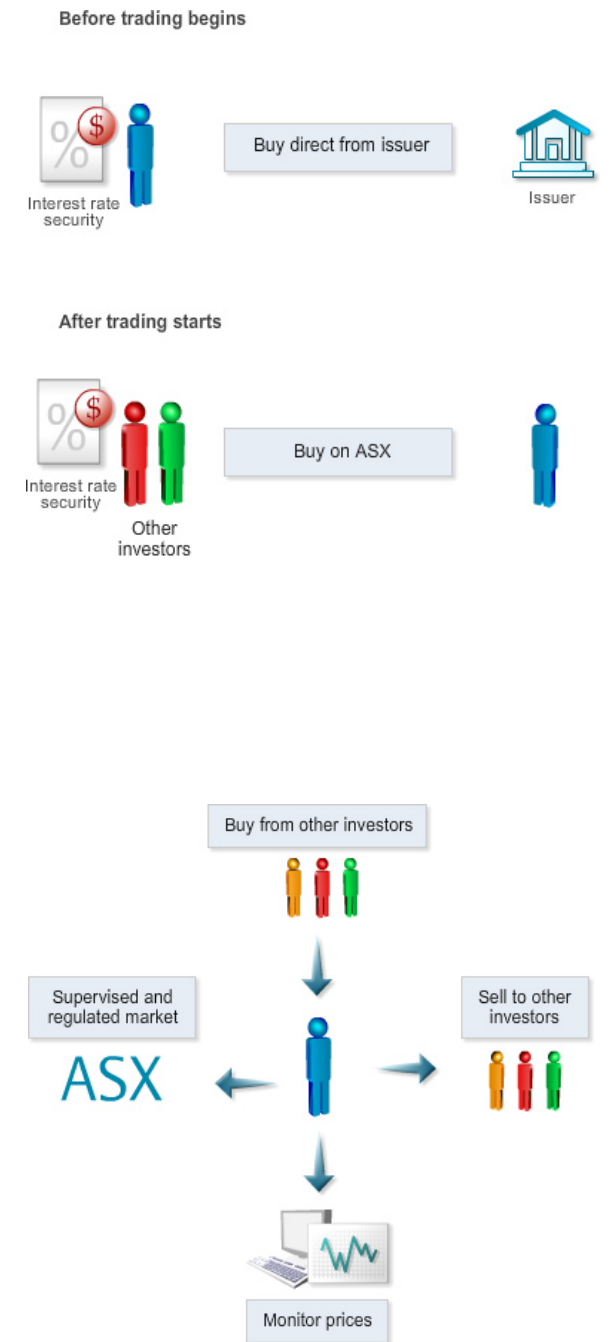
Once trading starts on market, you can buy on ASX, just as you would buy shares.

Tradeable instrument

Interest rate securities listed and traded on ASX enable you to:

- sell all or part of your investment to other investors
- add to your holding by buying more securities
- access market prices
- trade on a market that is strictly supervised and regulated.

	Shareholders	Creditors
Payment of interest/dividends	Lower ranking	Higher ranking
Repayment of capital	Lower ranking	Higher ranking



Topic 3: Comparing interest rate securities to shares

Shares and interest rate securities are both traded on ASX.

There are some similarities between the two instruments, but also some important differences.

First, let's take a look at the similarities.

Similarities: trading and settlement

Buying and selling interest rate securities on ASX is no different to buying and selling shares. You instruct your broker to place an order, either by phone or online. Trades are executed on the ASX trading system.

As with shares, settlement of the trade takes place three business days after the transaction (T+3). If you are broker-sponsored, you receive a CHESST statement recording your holding, just as you do when you buy shares on-market.

Similarities: ASX Rules

Once a company lists its shares or interest rate securities, it must comply with ASX Listing Rules, including:

- keeping the market fully informed, via company announcements, and
- publishing details of distributions (dividends and interest payments).

Trading of interest rate securities is governed by the same Market Rules that cover the trading of ordinary shares. They aim, among other things, to promote:

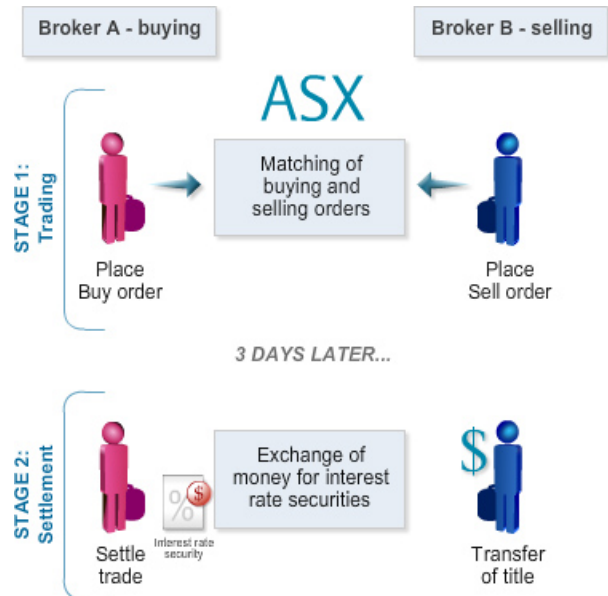
- fair and orderly trading, and
- a transparent market.

Differences between interest rate securities and shares

Higher face value

Interest rate securities typically have a higher face value than shares.

Most interest rate securities are issued with a face value of \$100.



Code	Buy	Sell	Last	Coupon	Maturity Date	Status
TAHHA	104.300	104.500	104.500	8.477%	01/05/2014	XI

Limited life

Most, though not all, interest rate securities have a maturity date, at which point either repayment of face value or conversion into ordinary shares takes place.

Ordinary shares, by contrast, have an unlimited life.

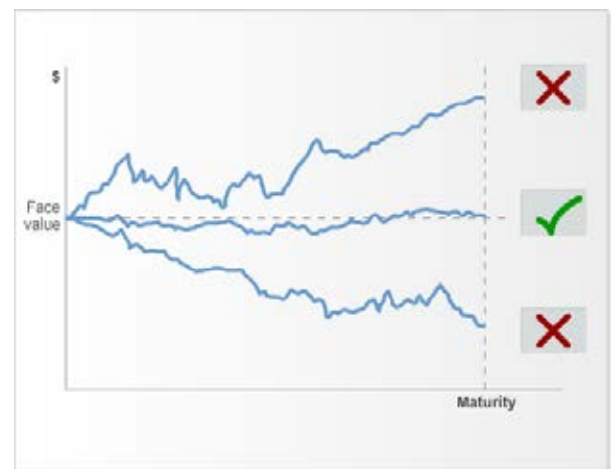
Differences between interest rate securities and shares

Capital growth potential

The return from most interest rate securities is primarily in the form of income. The potential for capital growth is generally a secondary consideration.

While an interest rate security may not trade at exactly its face value throughout its life, price fluctuations are typically smaller, in percentage terms, than share price movements.

As maturity nears, the price of an interest rate security tends to approach face value. There are no such constraints on share price movements.



Differences between interest rate securities and shares

Security of income and capital

Holders of interest rate securities rank 'higher' than ordinary shareholders for income payments, and the repayment of the initial investment.

A company may not pay dividends to ordinary shareholders until it has paid interest and dividends owing to interest rate security holders.

If a company goes into liquidation, interest rate security holders will generally have priority of repayment of face value of their security before ordinary shareholders receive any distribution.

Order of payment	Type of payment
1	Interest to interest rate security holders
2	Dividends to interest rate security holders
3	Dividends to ordinary shareholders

Differences between interest rate securities and shares

Non-standardised

The concept of a fully paid 'ordinary share' means the same thing regardless of the company you invest in.

Interest rate securities are not standardised. There are several types of interest rate security, each with different characteristics. Within each type, product features can vary significantly.

It is essential to become familiar with the details of any securities you are considering investing in by reading the prospectus.



Topic 4: Range of products

Product types

There are three main types of interest rate security traded on ASX:

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

Corporate bonds/notes are debt securities. Preference shares and convertible notes are 'hybrid' securities, having features of both debt and equity.

Each of these product types is covered in detail in a separate module, but for now we'll take a brief look at the main features of each.

Corporate bonds/notes

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

At maturity of the bond, the company repays you the face value. Along the way you receive interest, which will be either a fixed rate, or a floating rate that moves in line with market interest rates.

The return you earn is generally higher than the rate paid by a bank deposit.

A corporate bond does not provide the option to convert into shares.

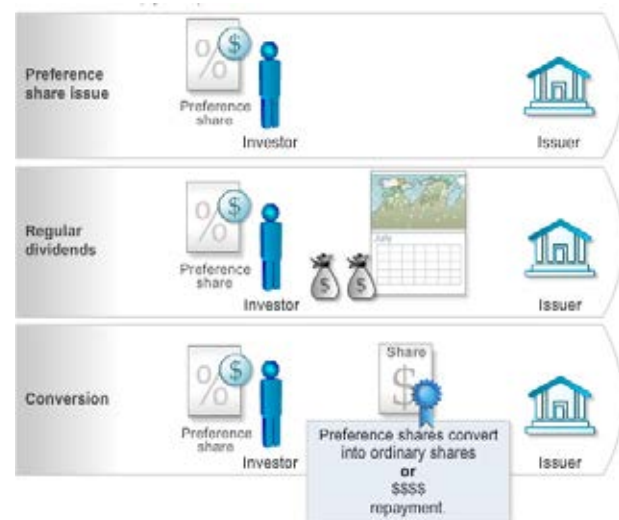
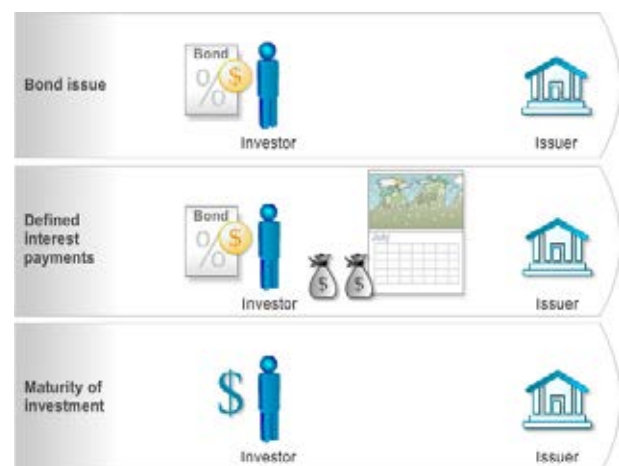
Corporate bonds/notes are covered in Module 4.

Preference shares (hybrids)

Preference shares pay income in the form of dividends, which may or may not be franked. The dividend rate may be fixed at the time of issue, or may float in line with market interest rates.

Preference shares are usually 'converting' or 'convertible', signifying that at some point they may be converted into ordinary shares in the company. There may also be an option to repay the face value in cash.

Security	Type
Preference shares	Hybrid
Corporate bonds/notes	Debt security
Convertible notes	Hybrid



The term 'preference' indicates that you rank ahead of the company's ordinary shareholders when it comes to the payment of dividends, and have a prior claim on the company's assets if the company is wound up.

Preference shares are covered in Module 5.

Convertible notes

A convertible note can be thought of as a bond with a conversion feature.

Like a bond, a convertible note:

- pays a defined income stream
- repays face value at a specified future date.

Additionally, the holder has the right to convert the note into ordinary shares in the company at specified times.

Convertible notes are covered in Module 6.

Which product to choose?

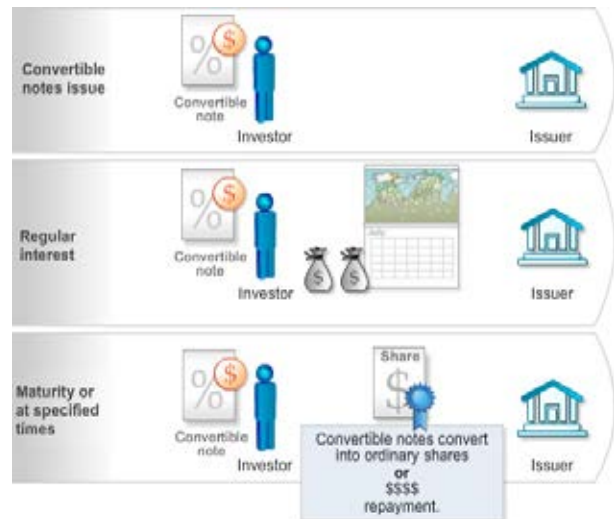
Comparing these product types, the three most important questions to ask are:

- What income will I receive?
- How do I get my money back?
- What are the risks?

In Module 2, we look at the income you get from an interest rate security.

In Module 3, we look at how you get your money back from an interest rate security.

In both modules, risk will be an important part of the discussion.

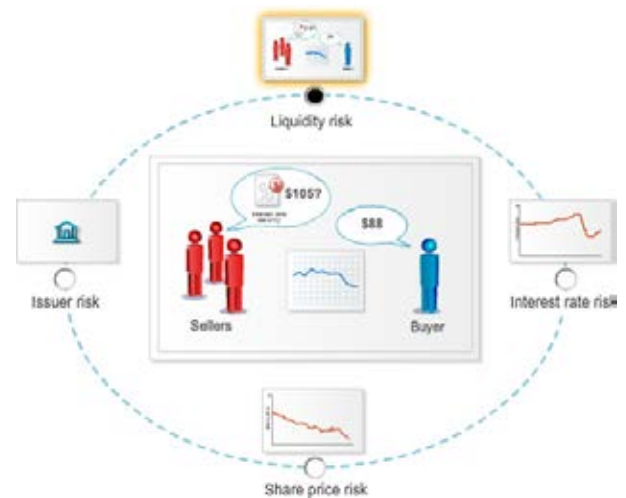


Topic 5: Risks of interest rate securities

Like all investments, interest rate securities involve risk.

The main risks are that:

- the company will be unable to pay the promised distributions, or repay the face value at maturity (issuer risk)
- your income will be affected by an unfavourable movement in market interest rates (interest rate risk)
- the value of your securities may be affected by changes in the company's share price, and
- you may not be able to sell your securities for a fair price (liquidity risk).



Let's look at these risks in more detail.

Issuer risk

You rely on the company that issued the securities to:

- pay the promised distributions, and
- repay the face value of the securities at maturity or convert your securities into shares.

It is essential to consider the company's creditworthiness when researching an investment in interest rate securities.

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

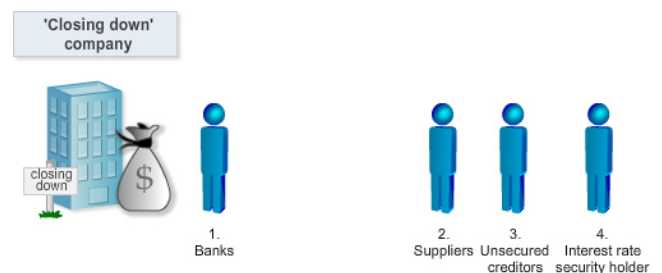
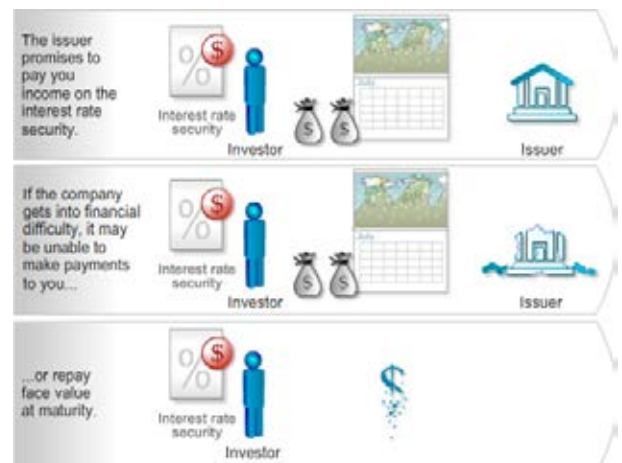
If the company goes into liquidation, you may not get all of your money back.

In Topic 3, we saw that holders of interest rate securities rank above shareholders.

However, most securities rank below secured creditors such as banks that have lent money to the company.

Most interest rate securities are:

- unsecured - i.e. not backed by any company assets, and
- subordinated - i.e. rank behind other creditors of the issuer.



If the company goes into liquidation, there is a risk that there may be no funds left for interest rate security holders after other creditors are repaid.

Interest rate risk

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

If your securities pay a fixed rate of interest, an increase in market interest rates means:

- you may receive less income than current market rates, and
- your securities may trade at a lower market price, as other investors will find them less attractive than investments that pay higher interest.

If your securities pay a floating rate, you are not hurt by an increase in interest rates. As rates rise, the income you receive will also increase. Conversely, as rates fall your income will decrease.

	Fixed rate security	Floating rate security
Income payment	Unchanged	Increases
Value of security	May fall	Unaffected

Performance of the company's shares

If your interest rate securities include the possibility of conversion into ordinary shares, the value of your securities may be affected by changes in the share price.

Most interest rate securities move little in response to share price movements, but some move in parallel with the share price.

How much they are affected depends mainly on the way your securities convert into shares. (The two main conversion mechanisms are covered in Module 3.)



Risk of being unable to sell your securities (liquidity risk)

Many investors hold their interest rate securities until maturity.

If, however, you want to sell your investment before this point, you will need to do so on market.

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



Summary

Interest rate securities traded on ASX:

- pay a defined income stream
- generally return their face value at maturity
- enable you to diversify your investments
- are bought and sold just like ordinary shares
- may offer tax advantages.

Interest rate securities represent a loan by the investor to the issuer.

For the term of the investment the company pays you income in the form of interest or dividends. Generally the company also promises to repay you the face value of your securities at a specified time in the future, or your securities may convert into ordinary shares.

There are three main types of interest rate security:

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

The main risks of interest rate securities include:

- the credit risk of the company that issued the securities, and
- the risk that interest rates will move unfavourably.