



Australian Income Securities Research

Monthly Review October 2012

1.	Income Security Best Ideas	2
2.	Rate Sheet at 18 October 2012	3
3.	Recommendation Changes since Last Month	4
4.	Monthly Market Review	5
5.	New Issues, Maturities and Resets	5
6.	Outlook and Comparative Yield	6
7.	Major Bank Income Securities	7
8.	Other Floating-Rate Income Securities	9
9.	Fixed-Rate Income Securities	11
10.	Glossary	13



1. Income Security Best Ideas

ASX Code	Name	Recommendation	Risk	Gross Running Yield
AQHHA	APA Group Subordinated Notes	Accumulate	Medium	7.80%

AQHHA are subordinated, unsecured securities with a \$100 face value. They have a legal maturity of 30-Sept-2072 and but APA Group has an option to redeem them early on 30-Mar-2018-, or on any subsequent interest payment date. The notes pay quarterly interest based on the 90-day BBSW rate plus a 4.50% p.a margin. The notes rank ahead of APA ordinary shares but below senior debt facilities. The interest payments are deferrable at the discretion of directors but cumulative and compounding meaning that the issuer will accrue a liability with missed payments. They are currently trading below our fair value estimate and offer a running yield of 7.88%.

ANZPA	ANZ CPS2	Accumulate	Low	6.44%
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ANZPA are Convertible Preference Shares of ANZ with a face value of \$100. ANZPB are unsecured securities with a mandatory conversion date of 15 December 2016, subject to conversion conditions. They pay non-cumulative, floating rate, fully franked distributions at a 3.10% margin above 90-Day BBSW. They are currently trading below fair value and offer a gross running yield of 6.44% and 6.49% yield to reset.

CBAPA	CBA Perls V	Accumulate	Low	6.65%
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CBAPA are exchangeable resaleable listed securities in CBA with a face value of \$200. CBAPA are classified as perpetual securities as there is no maturity date, however there is a mandatory conversion date of 31 Oct 2014 subject to the call rights of the issuer. They pay non-cumulative, fully franked distributions at a 3.40% margin above 90-Day BBSW. They are currently trading below our fair value estimate and offer a gross running yield of 6.65% and 6.64% yield to reset.

WBCPA	WBC SPS	Accumulate	Medium	5.70%
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WBCPA are stapled preferred securities of WBC with a face value of \$100. WBCPA are stapled unsecured securities with a mandatory conversion date of 26 September 2013, subject to conversion conditions. They pay non-cumulative, floating rate, fully franked distributions at a 2.40% margin above 90-Day BBSW. They are currently trading below fair value and offer a gross running yield of 5.70% and 6.06% yield to reset..

GMPPA	Goodman PLUS II	Accumulate	Medium	7.98%
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Goodman PLUS II are an amended version of Goodman PLUS securities issued by GMG with a face value of \$100. GMPPA holders have a redemption date of 31 December 2073 with an issuer remarketing option on 21 March 2018. They pay non-cumulative, unfranked distributions at a 3.90% margin above 90-Day BBSW. They are currently trading below our fair value estimate and offer a gross running yield of 7.98% and 9.60% yield to reset.

2. Rate Sheet at 18 October 2012

Code	Recommendation	Price (\$)	Issuer	Issue Size (\$m)	Years To Maturity	Trading Margin	Running Yield		Yield to Reset		Dist (\$)	Ex Date
							inc Fr	ex Fr	inc Fr	ex Fr		
AAZPB	NOT COVERED	94.00	ALZ	269	-	5.40%	8.79%	8.79%	-	-	2.10	24/09/2012
AGKHA	HOLD	103.00	AGK	650	6.64	3.40%	7.00%	7.00%	6.72%	6.72%	1.84	26/11/2012
ANZHA	HOLD	103.00	ANZ	1509	4.65	2.18%	5.90%	5.90%	5.44%	5.44%	1.53	6/12/2012
ANZPA	ACCUMULATE	100.39	ANZ	1970	4.16	3.16%	6.44%	4.51%	6.49%	4.47%	1.16	26/11/2012
ANZPB	ACCUMULATE	99.99	ANZ	1081	1.66	2.85%	5.83%	4.08%	6.20%	4.31%	1.05	26/11/2012
ANZPC	ACCUMULATE	99.00	ANZ	1340	4.87	3.55%	6.46%	4.52%	6.82%	4.81%	2.27	8/02/2013
AQHHA	ACCUMULATE	101.76	APA	515	5.45	4.20%	7.80%	7.80%	7.63%	7.63%	2.30	17/12/2012
AQNHA	NOT COVERED	106.00	AMP	300	1.57	2.08%	7.81%	7.81%	5.02%	5.02%	2.12	31/10/2012
BENPC	HOLD	89.85	BEN	100	1.98	7.48%	5.60%	3.92%	11.19	9.48%	0.87	17/12/2012
BOQPC	REDUCE	92.00	BOQ	200	-	2.51%	5.64%	3.95%	-	-	2.17	18/09/2012
CBAHA	ACCUMULATE	98.80	CBA	575	3.18	1.46%	4.33%	4.33%	4.71%	4.71%	1.07	31/12/2012
CBAPA	ACCUMULATE	201.95	CBA	2000	2.03	2.75%	6.65%	4.66%	6.06%	4.07%	2.46	18/10/2012
CBAPB	HOLD	199.89	CBA	1465	0.03	-	4.27%	2.99%	1.69%	1.69%	1.39	10/10/2012
CBAPC	ACCUMULATE	101.40	CBA	2000	6.16	3.66%	7.10%	4.97%	7.00%	4.79%	0.79	3/12/2012
CNGHA	ACCUMULATE	102.45	CNG	1000	4.45	2.71%	6.44%	6.44%	6.00%	6.00%	1.65	17/12/2012
CTXHA	HOLD	103.90	CTX	550	4.91	3.76%	7.66%	7.66%	7.14%	7.14%	2.23	3/12/2012
CWNHA	HOLD	101.60	CWN	532	5.91	4.84%	8.37%	8.37%	8.24%	8.24%	2.01	30/11/2012
GMPPA	ACCUMULATE	91.85	GMG	327	4.95	6.03%	7.98%	7.98%	9.60%	9.60%	1.37	10/09/2012
IAGPC	HOLD	98.50	IAG	377	4.53	4.33%	7.35%	5.14%	7.58%	5.38%	2.82	18/10/2012
IANG	ACCUMULATE	101.70	IAG	550	7.16	3.82%	7.29%	5.10%	7.17%	4.90%	1.31	3/12/2012
MBLHB	ACCUMULATE	63.60	MQG	400	-	4.87%	7.90%	7.90%	-	-	1.31	20/12/2012
MQCPA	HOLD	103.51	MQG	600	0.70	-	11.44%	11.44%	11.13	11.13	5.53	15/06/2012
MXUPA	NOT COVERED	76.90	NA	450	-	6.20%	9.49%	9.49%	-	-	1.79	24/09/2012
NABHA	ACCUMULATE	71.70	NAB	2000	-	3.34%	6.39%	6.39%	-	-	1.24	24/10/2012
NABHB	HOLD	103.90	NAB	1173	4.67	1.95%	5.85%	5.85%	5.20%	5.20%	1.56	4/12/2012
NFNG	ACCUMULATE	80.90	NUF	251	-	5.76%	8.90%	8.90%	-	-	4.05	28/03/2013
ORGHA	HOLD	102.00	ORG	900	4.18	3.61%	7.26%	7.26%	6.93%	6.93%	1.84	10/12/2012
PCAPA	ACCUMULATE	182.20	CBA	1166	3.47	3.97%	4.71%	3.30%	7.37%	5.96%	1.48	21/12/2012
PRYHA	NOT COVERED	102.00	PRY	152	2.94	3.42%	7.25%	7.25%	6.74%	6.74%	1.83	14/12/2012
RHCPA	HOLD	101.85	RHC	260	-	4.69%	7.97%	5.58%	-	-	3.20	28/09/2012
SBKHB	NOT COVERED	57.60	SUN	170	-	4.18%	7.06%	7.06%	-	-	1.11	9/11/2012
SBKPA	NOT COVERED	97.90	SUN	30	3.91	-	6.29%	4.41%	6.92%	4.98%	2.12	27/08/2012
SBKPB	HOLD	99.80	SUN	735	0.65	4.37%	6.58%	4.61%	8.03%	5.66%	1.19	28/11/2012
SVWPA	ACCUMULATE	87.00	SVW	496	-	6.44%	9.64%	6.75%	-	-	3.21	10/05/2012
TAHHA	HOLD	105.00	TAH	284	1.53	2.11%	7.36%	7.36%	5.07%	5.07%	1.99	31/10/2012
TAHHB	HOLD	99.50	TAH	250	4.42	4.27%	7.45%	7.45%	7.65%	7.65%	1.84	10/12/2012
TPAPA	AVOID	85.00	TPI	250	-	7.82%	11.10%	7.77%	-	-	3.23	22/03/2013
TTSHA	HOLD	103.50	TTS	195	6.71	2.51%	6.21%	6.21%	5.79%	5.79%	1.62	20/12/2012
WBCHA	HOLD	103.03	WBC	1676	4.85	2.28%	5.93%	5.93%	5.54%	5.54%	1.61	9/11/2012
WBCPA	ACCUMULATE	100.00	WBC	1036	0.94	2.70%	5.70%	3.99%	6.06%	4.21%	1.01	17/12/2012
WBPCB	ACCUMULATE	102.80	WBC	908	1.95	2.51%	6.98%	4.89%	5.77%	3.58%	1.25	17/12/2012
WBPCPC	ACCUMULATE	98.90	WBC	1189	5.45	3.57%	6.57%	4.60%	6.81%	4.80%	2.27	18/03/2013
WCTPA	ACCUMULATE	88.75	WBC	763	3.70	4.52%	4.79%	3.35%	8.00%	6.56%	0.76	6/12/2012
WOWHC	HOLD	105.90	WOW	700	4.10	2.03%	6.26%	6.26%	5.24%	5.24%	1.77	12/11/2012

Source: Morningstar (yields) and ASX (prices and ex-dates) - Yields and trading margins above 30% are not displayed.

Ex-dates and distributions are the latest reported by the ASX at the 18 October 2012.

3. Recommendation Changes since Last Month

- ▶ PERLS VI – On the 18th October 2012 PERLS VI (the first Basel III compliant hybrid in Australia) began trading on the ASX. This structure is largely untested in the domestic landscape and hence it is difficult to interpret how it will perform. The structural features embedded in this security have been evident in previous issues but never all at once. Morningstar expects the security will trade in line with expectations and the risk to the downside is subject to macroeconomic deterioration and incumbent non-performing loans. Morningstar has initiated coverage on CBAPC with an **Accumulate** recommendation. On the 5th October 2012 the CBA announced that CBAPB holders who reinvest their capital into CBAPC will receive their final adjusted distribution on 23 October 2012. Those people who do not reinvest their proceeds will also receive an adjusted distribution on 31 October 2012 with the return of face value. In total PERLS VI raised \$2bn in new capital with the initial distribution set at 6.95% which is to be paid on 7 December 2012.
- ▶ APA Group Subordinated Notes – On 26 September 2012 we initiated coverage with an **Accumulate** recommendation. The notes quickly traded up to ~\$101 which post adjustment for accrued interest represents a credit spread of ~430bps. This is on the fringe of our accumulate recommendation but below our fair value estimated and continues to look attractive at the levels (YTR 7.80%). AQHHA is structurally comparable to the Origin Energy Subordinated Notes issue (ORGHA) due to the long legal final maturity and step up terms which is primarily as a result of conditions to equity credit classification by Moodys. The security is priced to the expected maturity date on 31 March 2018 with funds being used in combination with US private placement to manage the Hastings Diversified acquisition.
- ▶ Crown Subordinated Notes – On 25 September 2012 we initiated coverage on CWNHA with an **Accumulate** recommendation. In the first few weeks the notes have traded around our fair value estimate (trading margin of 4.85%) but given the broad rally in listed income securities we will wait for the capital price to normalize before adjusting our recommendation. We expect this security to be slightly more volatile than securities from regulated sectors (i.e. Banks, Insurance) but it remains good value relative to other comparable gaming securities (TAHHB - 4.39%). As with AQHHA, this security is structurally comparable to the Origin Energy Subordinated Notes issue (ORGHA) due to the long legal final maturity and step up terms which is primarily as a result of conditions to equity credit classification by Moodys. The security is priced to the expected maturity date on 14 September 2018.
- ▶ On the 28th September 2012, GMPPA (Goodman PLUS II) resumed trading on the ASX with the new terms which were approved by special resolution. The key elements of the changes included: the margin being increased two interest payments periods early from 1.90% p.pa to 3.9%p.a, the notes becoming long dated with a 61 year term and a first remarketing date at 30 September 2017. After careful analysis post restructure Morningstar upgraded its recommendation to **Accumulate**.
- ▶ The past month has seen a broad based rally in the income securities market with a specific focus on the recently issued bank tier 2 instruments. Although these securities are considered safer than tier 1 securities from equivalent issuers, the increased capital price (and inherent drop in trading margin ~200bps over benchmark) suggests that they are now trading at fair value. We adjust our recommendation on ANZHA, NABHB, WBCHA and AGKHA to **Hold**.
- ▶ We have extended the coverage period of BENPC, BOQPC, TPAPA, NFNG until 31-Jan-2013

4. Monthly Market Review

- ▶ Global share markets performed well in the month of September even as the global economic outlook, according to the IMF, appeared to deteriorate. The central banks of the world's major economies put on a unified front and swamped the markets with liquidity (through their own asset purchase programs) which gave confidence to investors after a disappointing performance YTD.
- ▶ The S&P/ASX All Ordinaries Index returned 2.13% for the month (8.2% for the quarter) which was largely attributable to broad market price/earnings expansion and a sector led rally by the domestic banks. On our numbers, the market is trading virtually bang on fair value, with the median discount to fair value just 2% across the 220 Australian stocks in our coverage universe. This compares to the 12% undervaluation in late June.
- ▶ China's month was influenced by "Golden Week", which was introduced in 2000 by the People's Republic to promote tourism and private consumption. Initial expectations were strong with the number of people travelling during the period up 23% year-on-year. However, this did not translate into greater consumption with retail sales growth for the period down by 2%. The Shanghai Composite Index increased by 1.89% in September but suffered a poor quarter with a 6.26% drop.
- ▶ The S&P/ASX Australian Corporate Bond Index continued its strong positive run for the year returning 1.41% for the month of September. Corporate bonds have proven to be the most resilient segment of the broader S&P/ASX Australian Fixed Interest index, delivering a positive 9.56% YTD return.

5. New Issues, Maturities and Resets

- ▶ Goodman PLUS II – On the 26th September 2012, Goodman PLUS holders approved amendments to the PLUS terms, the Guarantee and the Implementation Deed via voting in favor of all amendments at a special resolution meeting. Goodman PLUS II became effective 27 September 2012. The changes were unanimously approved (~80% voted for) and hence the margin will step up 3.90% p.a as of the next payment date and the new remarketing date is 21st March 2018. As previously discussed our preference would have been for the notes to be redeemed and funded by a new security issue. However, this result is the better option than holding Goodman PLUS if the proposal is not approved.
- ▶ On 25th September 2012, SUN announced a hybrid issue SUN CPS II (ASX Code: SUNPC). This is another mandatory converting hybrid. SUNPC are perpetual, exchangeable, unsecured, subordinated securities with a mandatory exchange date of 17 December 2019 (subject to conditions), unless they are redeemed or exchanged earlier on the optional exchange date (17 December 2017). The security will pay discretionary but fully franked dividends which are non-cumulative and payable quarterly in arrears based on the 90-day BBSW rate plus 4.65%. The offer will close on the 20th October 2012 (5th November for Broker Firm Offer) and was upsized to at least \$500M. It will begin trading on the ASX on the 7th November 2012.

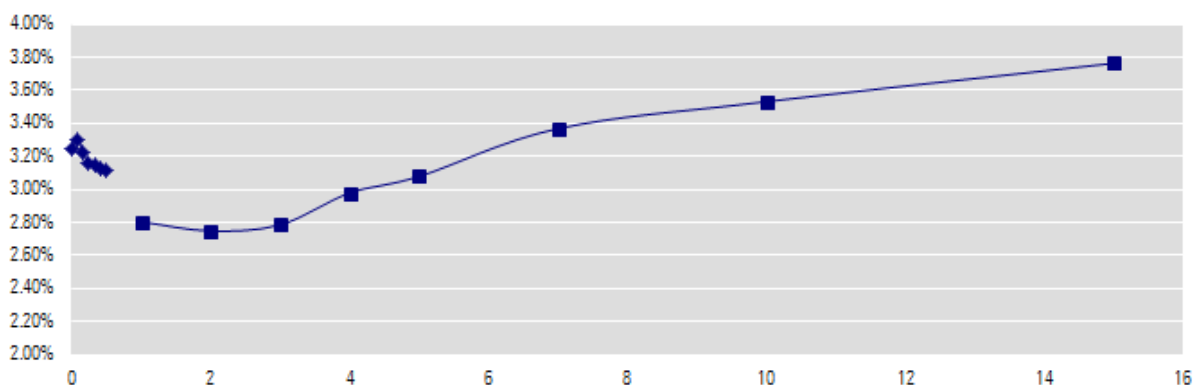
6. Outlook and Comparative Yield

One thing is clear for income investors; the absolute yield derived from the benchmarks interest rates is dropping and is likely to continue to drop well into 2013. This will reduce the absolute yield of hybrid instruments and in turn diminish expectations for future income from these securities. As previously discussed the listed income universe is dominated by floating rate notes and hence the performance will be dictated by the credit spread rather than any movements in the underlying benchmark but benchmark returns must be considered when making relative value decisions.

Since our last monthly publication central banks in Japan, USA and UK announced further stimulus programs for their fragile economies. The poor economic conditions in Europe had spread to Asia and had become a key concern for the RBA board in the lead-up to the official October policy meeting, prompting a cut by 25bps to 3.25%. Morningstar believes a further cut on Melbourne Cup day is likely with interest rate futures pricing in an 83% chance of rate cut in November.

Economists are lowering their forward expectations of the official rate and 2.5% looks like the consensus for mid-2013. In contrast, the futures market is pricing in an even lower rate by April. However, there is justification to suggest that the 150bp of cuts over the past year and tentative signs of rising house prices could potentially fuel an asset bubble. The RBA is likely to be more reactive to sharp economic slowdown than proactive in defending its inflation position. Inflation figures are due to be released on the 24th October and if these are within the desirable range the probability of a rate cut will increase further.

Figure 6.1 AUD Swap Rates Annualised



Source: Morningstar/Reuters

	Bank Bill Rate		IR Swap (Fixed Leg)
RBA Cash Rate	3.25%	1 year	2.80%
1 month	3.30%	2 year	2.75%
2 month	3.22%	3 year	2.79%
3 month	3.15%	4 year	2.98%
4 month	3.14%	5 year	3.08%
5 month	3.13%	7 year	3.37%
6 month	3.11%	10 year	3.53%

Source: Reuters

7. Major Bank Income Securities

The Bank Income Security sector has had a relatively quiet month as the market absorbs both the jumbo PERLS VI (CBAPC) issue and the Bendigo & Adelaide CPS. The final issue size of CBAPC was \$2.0bn with the redemption of PERLS IV on the 30th October this leaves us with a net increase of \$600M in CBA additional tier 1 capital. We will closely follow the performance of this security as it will be the benchmark for performance of the hybrid sector going forward.

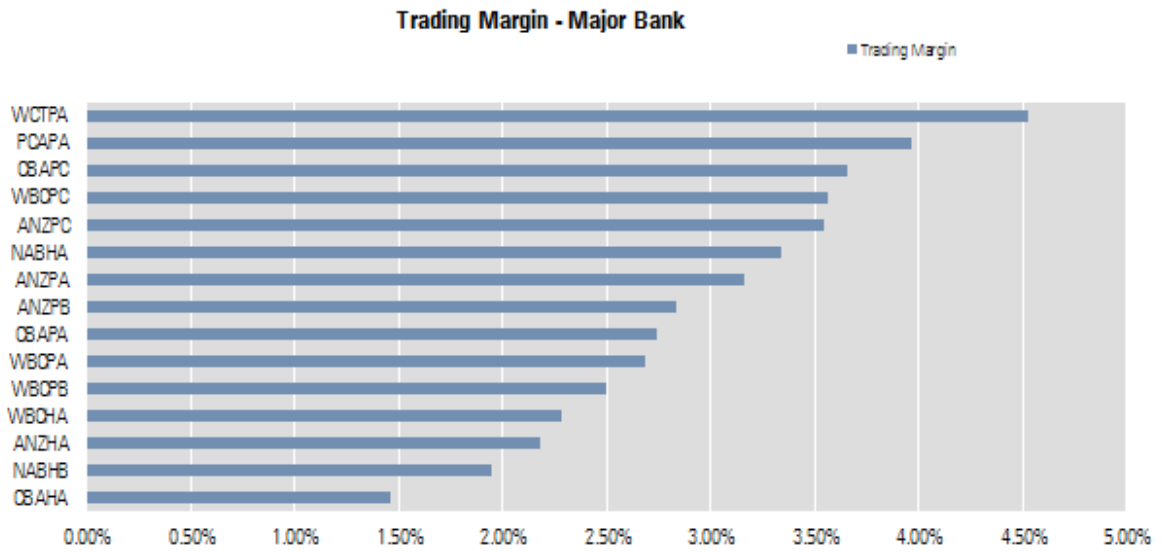
Banking securities performed well during the month with trading margins remaining fairly stable. The trust preferred securities (i.e. WCTPA, PCAPA) continue to be relatively high beta compared with other tier 1 instruments but tightened on the month to slightly outperform other tier 1 instruments.

On 28th September 2012 APRA announced the final Basel III capital reform package which has set the new prudential regulations. The announcement included the removal of the distributable profits test (the requirement for APRA's approval of payments by banking institutions in relation to Additional Tier 1 and Tier 2 instruments) for bank hybrids. APRA stated that "it considers the costs of maintaining the annual profits test on bank hybrid capital instruments to outweigh the supervisory benefits, given the fundamental change to the nature and required levels of hybrid capital under Basel III".

It is arguable whether or not this change actually changes the risk profile of hybrid securities. Rating agencies were mixed in their views as some say it improves the repayment capacity on their hybrid capital obligations but others are stricter and suggest it changes nothing because the payments are purely discretionary. Morningstar remains on the conservative side of these assumptions and penalizes the issuer for discretionary payments.

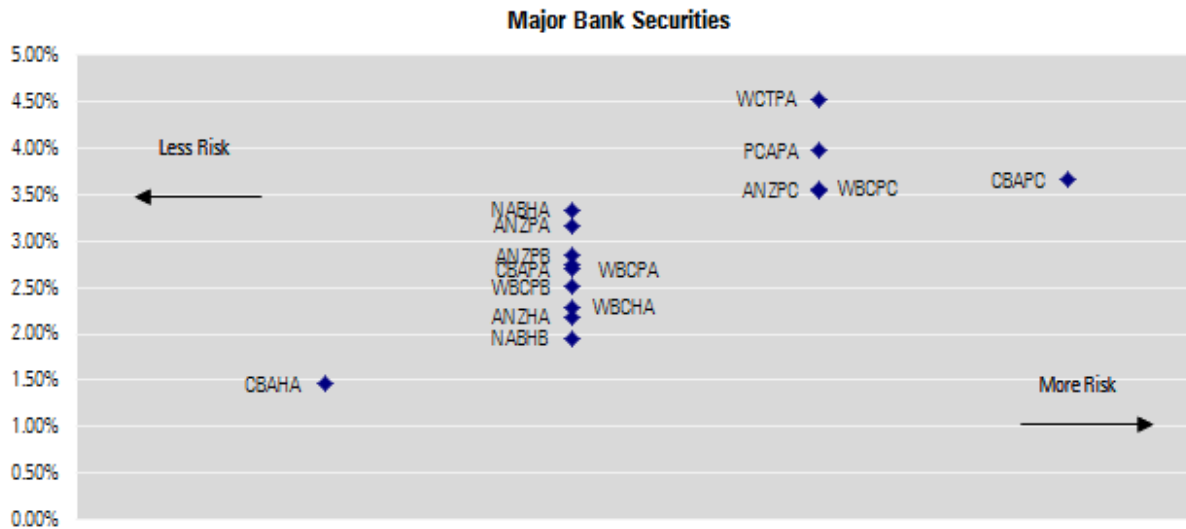
Code	Recommendation	Price(\$)	Issuer	Issue Size (\$m)	Years To Maturity	Trading Margin	Running Yield		Yield to Reset		Dist (\$)	Ex Date
							inc Fr	ex Fr	inc Fr	ex Fr		
ANZHA	HOLD	103.00	ANZ	1508.65	4.65	2.18%	5.90%	5.90%	5.44%	5.44%	1.53	6/12/2012
ANZPA	ACCUMULATE	100.39	ANZ	1970.00	4.16	3.16%	6.44%	4.51%	6.49%	4.47%	1.16	26/11/2012
ANZPB	ACCUMULATE	99.99	ANZ	1081.21	1.66	2.85%	5.83%	4.08%	6.20%	4.31%	1.05	26/11/2012
ANZPC	ACCUMULATE	99.00	ANZ	1340.00	4.87	3.55%	6.46%	4.52%	6.82%	4.81%	2.27	8/02/2013
CBAHA	ACCUMULATE	98.80	CBA	575.00	3.18	1.46%	4.33%	4.33%	4.71%	4.71%	1.07	31/12/2012
CBAPA	ACCUMULATE	201.95	CBA	2000.00	2.03	2.75%	6.65%	4.66%	6.06%	4.07%	2.46	18/10/2012
CBAPC	ACCUMULATE	101.40	CBA	2000.00	6.16	3.66%	7.10%	4.97%	7.00%	4.79%	0.79	3/12/2012
NABHA	ACCUMULATE	71.70	NAB	2000.00	-	3.34%	6.39%	6.39%	-	-	1.24	24/10/2012
NABHB	HOLD	103.90	NAB	1172.51	4.67	1.95%	5.85%	5.85%	5.20%	5.20%	1.56	4/12/2012
PCAPA	ACCUMULATE	182.20	CBA	1166.46	3.47	3.97%	4.71%	3.30%	7.37%	5.96%	1.48	21/12/2012
WBCHA	HOLD	103.03	WBC	1676.22	4.85	2.28%	5.93%	5.93%	5.54%	5.54%	1.61	9/11/2012
WBCHA	ACCUMULATE	100.00	WBC	1036.27	0.94	2.70%	5.70%	3.99%	6.06%	4.21%	1.01	17/12/2012
WBCHA	ACCUMULATE	102.80	WBC	908.33	1.95	2.51%	6.98%	4.89%	5.77%	3.58%	1.25	17/12/2012
WBCHA	ACCUMULATE	98.90	WBC	1189.36	5.45	3.57%	6.57%	4.60%	6.81%	4.80%	2.27	18/03/2013
WCTPA	ACCUMULATE	88.75	WBC	762.74	3.70	4.52%	4.79%	3.35%	8.00%	6.56%	0.76	6/12/2012

Figure 7.1 Major Bank Income Securities – Trading Margins



Source: Morningstar

Figure 7.2 Risk vs. Trading Margins



Source: Morningstar

8. Other Floating-Rate Income Securities

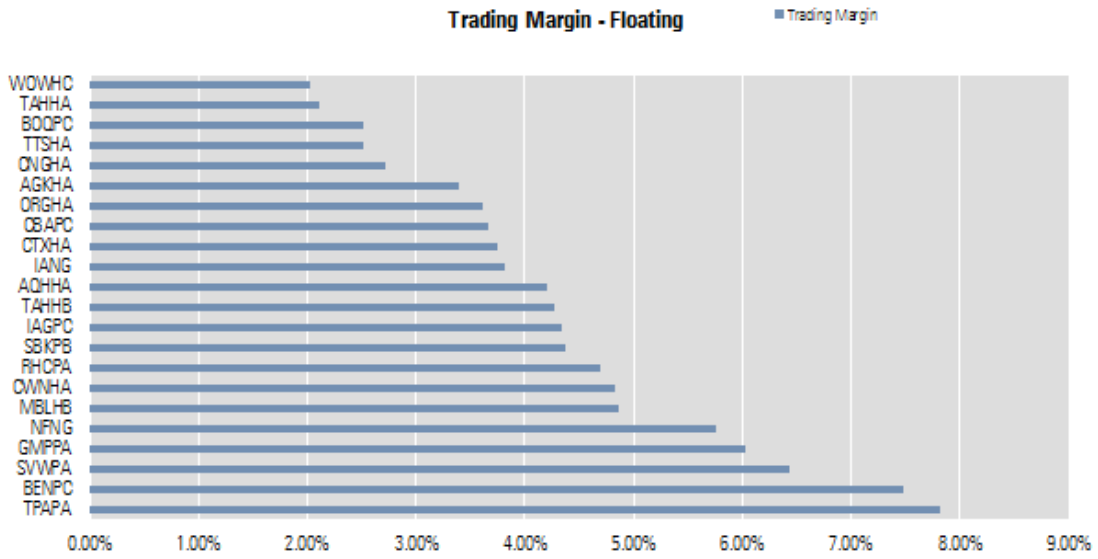
There has been no significant change to our non-bank universe over the past month with the exception of the new Suncorp CPS II transaction which is expected to close on the 5 November 2012.

The largest factor affecting floating rate income securities over the past few months is the substantial drop in the front end of the swap curve (i.e. 90 Day and 180 Day BBSW). Approximately 77% of securities under our coverage will be resetting their distribution/coupon payment before year end and with the substantial drop in swap rates since the beginning of 2012 (90-day BBSW dropped from ~4.50% to ~3.10%) the running yield is starting to look less attractive to investors. As discussed in yield outlook section, Morningstar believes this benchmark yield to continue to drop into early 2013 and from an absolute yield perspective this could begin to influence investor's asset allocation decisions.

Although changes to the benchmark interest rate have little impact on performance of floating rate securities the nominal income derived from these securities has reduced. This does not mean these securities are any less risky. Each instrument is made up of a benchmark interest rate (resets quarterly or semiannually) plus a margin. Once these instruments begin trading on the secondary market (ASX) this trading margin is the dynamic measure of the creditworthiness of the issuer and instrument. It has no influence on the underlying benchmark. Therefore, it is important to understand how domestic money markets work and what impact they can have on income related securities.

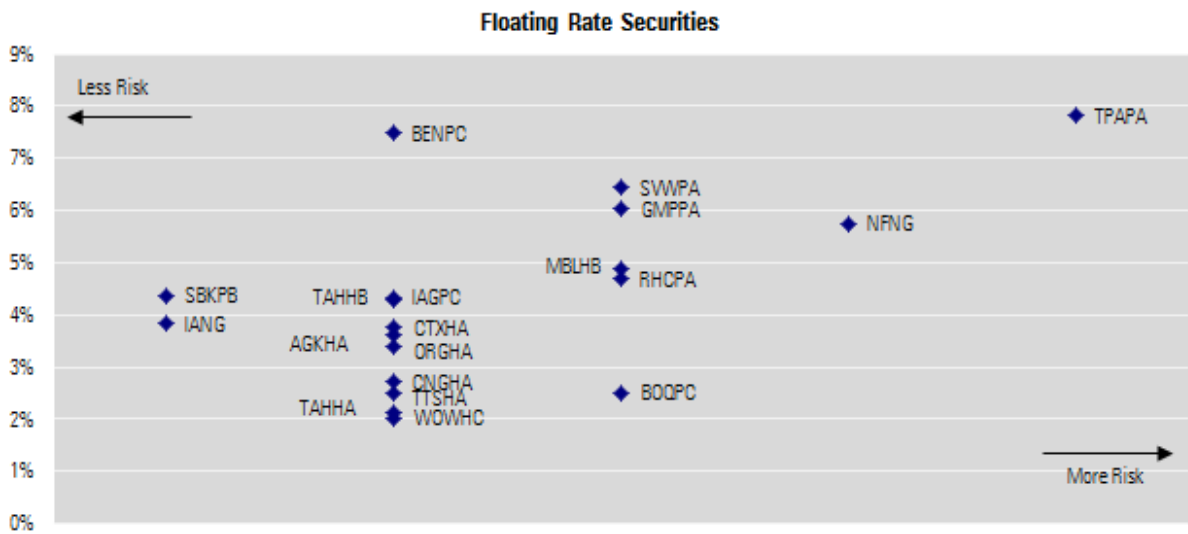
Code	Recommendation	Price (\$)	Issuer	Issue Size (\$m)	Years To Maturity	Trading Margin	Running Yield		Yield to Reset		Dist (\$)	Ex Date
							inc Fr	ex Fr	inc Fr	ex Fr		
AGKHA	HOLD	103.00	AGK	650	6.64	3.40%	7.00%	7.00%	6.72%	6.72%	1.84	26/11/2012
AQHHA	ACCUMULATE	101.76	APA	515	5.45	4.20%	7.80%	7.80%	7.63%	7.63%	2.30	17/12/2012
BENPC	HOLD	89.85	BEN	100	1.98	7.48%	5.60%	3.92%	11.19%	9.48%	0.87	17/12/2012
BOQPC	REDUCE	92.00	BOQ	200	-	2.51%	5.64%	3.95%	-	-	2.17	18/09/2012
CNGHA	ACCUMULATE	102.45	CNG	1000	4.45	2.71%	6.44%	6.44%	6.00%	6.00%	1.65	17/12/2012
CTXHA	HOLD	103.90	CTX	550	4.91	3.76%	7.66%	7.66%	7.14%	7.14%	2.23	3/12/2012
CWNHA	ACCUMULATE	101.60	CWN	532	5.91	4.84%	8.37%	8.37%	8.24%	8.24%	2.01	30/11/2012
GMPPA	ACCUMULATE	91.85	GMG	327	4.95	6.03%	7.98%	7.98%	9.60%	9.60%	1.37	10/09/2012
IAGPC	HOLD	98.50	IAG	377	4.53	4.33%	7.35%	5.14%	7.58%	5.38%	2.82	18/10/2012
IANG	ACCUMULATE	101.70	IAG	550	7.16	3.82%	7.29%	5.10%	7.17%	4.90%	1.31	3/12/2012
MBLHB	ACCUMULATE	63.60	MOG	400	-	4.87%	7.90%	7.90%	-	-	1.31	20/12/2012
NFNG	ACCUMULATE	80.90	NUF	251	-	5.76%	8.90%	8.90%	-	-	4.05	28/03/2013
ORGHA	HOLD	102.00	ORG	900	4.18	3.61%	7.26%	7.26%	6.93%	6.93%	1.84	10/12/2012
RHCPA	HOLD	101.85	RHC	260	-	4.69%	7.97%	5.58%	-	-	3.20	28/09/2012
SBKPB	HOLD	99.80	SUN	735	0.65	4.37%	6.58%	4.61%	8.03%	5.66%	1.19	28/11/2012
SVWPA	ACCUMULATE	87.00	SVW	496	-	6.44%	9.64%	6.75%	-	-	3.21	10/05/2012
TAHHA	HOLD	105.00	TAH	284	1.53	2.11%	7.36%	7.36%	5.07%	5.07%	1.99	31/10/2012
TAHHA	HOLD	99.50	TAH	250	4.42	4.27%	7.45%	7.45%	7.65%	7.65%	1.84	10/12/2012
TPAPA	AVOID	85.00	TPI	250	-	7.82%	11.10%	7.77%	-	-	3.23	22/03/2013
TSHA	ACCUMULATE	103.50	TTS	195	6.71	2.51%	6.21%	6.21%	5.79%	5.79%	1.62	20/12/2012
WOWHC	HOLD	105.90	WOW	700	4.10	2.03%	6.26%	6.26%	5.24%	5.24%	1.77	12/11/2012

Figure 8.1 Floating Rate Income Securities – Trading Margins



Source: Morningstar

Figure 8.2 Risk vs. Trading Margins



Source: Morningstar

9. Fixed-Rate Income Securities

The universe for fixed rate securities is limited and not the focus for our coverage.

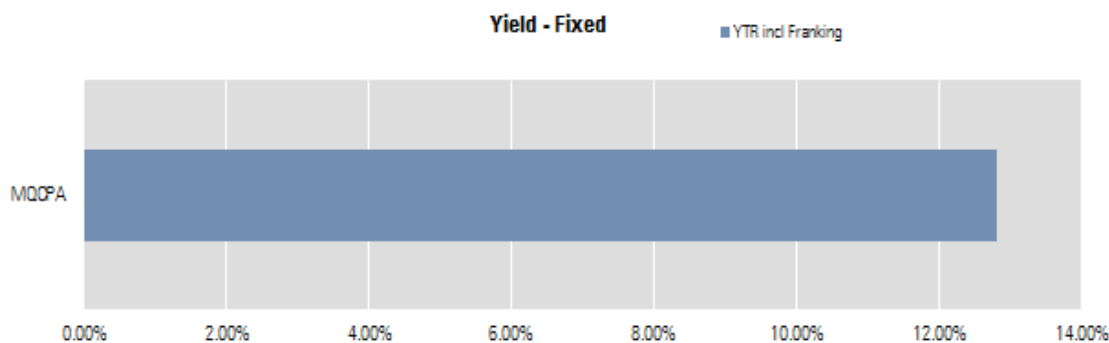
Macquarie Group CPS (ASX Code: MQCPA) has rallied over the past few months primarily as a result of the rally in the underlying benchmark yield (government bond curve) not because the security is lower risk. This is the only fixed rate security remaining under our coverage and we expect that on the first option redemption date (30 June 2013) Macquarie Group (MQG) will redeem these securities for cash. This is primarily because they do not comply with the new transitional eligibility criteria set out by APRA. This in turn makes MQCPA very expensive debt with no capital relief.

Although we believe MQCPA will be redeemed for cash there is a small possibility that if MQG does not sell/redeem these securities they mandatorily convert into MQG shares. This is subject to the conversion conditions (first being VWAP above \$27.10). We believe it is unlikely that MQCPA will be converted as it will dilute the existing shareholder base by ~6%. If conversion does not occur at that the initial conversion date then the conversion test will be applied at each subsequent payment date.

Also if conversion does not occur then MQCPA will become a floating rate security paying fully franked distributions at a 3.50% margin above the 90-day BBSW. In the current market this margin does not look attractive when you consider that major bank issued mandatory convertibles are trading at margins as high as 3.7%. The Macquarie Bank issued security MBLHB is trading at a margin around 5.2%. HOLD.

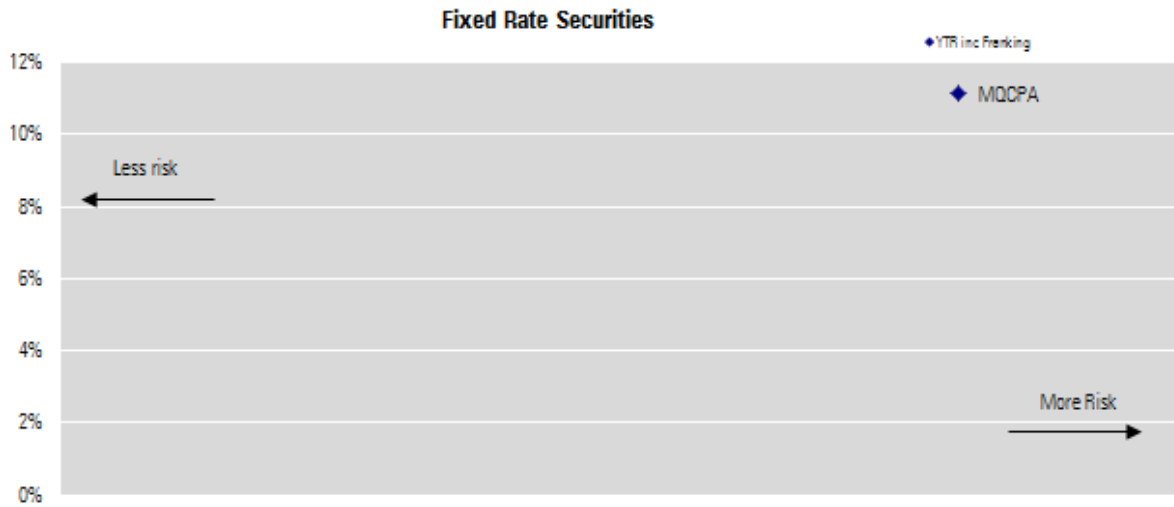
Code	Recommendation	Price (\$)	Issuer	Issue Size (\$m)	Years To Trading Maturity	Margin	Running Yield		Yield to Reset		Dist (\$)	Ex Date
							inc Fr	ex Fr	inc Fr	ex Fr		
MQCPA	HOLD	103.51	MQG	600.00	0.70	-	11.44%	11.44%	11.13%	11.13%	5.53	15/06/2012

Figure 9.1 Fixed Rate Yields



Source: Morningstar

Figure 9.2 Fixed Rate Yields Fixed Rate Income Securities – Risk vs. Yield



Source: Morningstar

10. Glossary

BBSW	The Bank Bill Swap Rate (BBSW) is the average mid rate for Australian dollar bills of exchange accepted by an approved bank, having a tenor with a designated maturity, that appears on an approved information vendor's service (e.g., Reuters Screen BBSW page).
Conversion	Under certain circumstances, the hybrid security may be converted into a number of ordinary shares of the underlying stock at a specified conversion number, subject to terms, conditions and corporate events, including conversion discount, conversion date and triggers.
Conversion Discount	A discount in percentage applied to the underlying stock price into which the hybrid security may be converted. Also referred to as exchange discount.
Conversion Number	The number of ordinary shares of the underlying stock into which the hybrid security may be able to convert. For certain hybrid securities, there may be a minimum and/or a maximum conversion number applied. The conversion number is generally calculated based on a formula: Conversion Number = Face Value / [VWAP x (1 – Conversion Discount)]
Convexity	A measure for bonds used in conjunction with modified duration in order to measure how the bond's price will change as interest rates change. It is equal to the opposite of the second derivative of the bond's price relative to its yield, divided by its price. For example, since a non-callable bond's duration usually increases as interest rates decrease, its convexity is positive.
Cumulative	Depending on the hybrid security, the dividend, distribution or coupon paid may or may not be cumulative. If the dividend, distribution or coupon is cumulative and if the issuer defers the payment of the dividend, distribution or coupon on any payment date, then additional dividend, distribution or coupon will accrue at the prevailing distribution rate.
Dividend Yield	Expressed as a percentage, dividend yield is the company's annual dividend payments divided by its market cap, or the dividend per share divided by price per share.
Duration	The change in the value of a fixed-income security that will result from a 1% change in interest rates. Duration is stated in years. For example, a five-year duration means the bond will decrease in value by 5% if interest rates rise 1% and will increase in value by 5% if interest rates fall 1%. Duration is a weighted measure of the length of time the bond will pay out.
Exchange	Exchange means the conversion, redemption, buy-back or cancellation of the hybrid security.
Face Value	The face value of the security is the issue price typically being \$100 per security.
Gross	Yield expressed, inclusive of any available franking credits or tax-deferred benefits.
Margin	Expressed as a percentage per annum, the margin offered by the hybrid security over a reference rate. The initial margin is typically determined by a bidding process within a prescribed margin range known as bookbuild. For certain hybrid securities, the margin may be increased (refer to Step-up) at a predetermined date.
Market Rate	See Reference Rate.
Mandatory Conversion	Some securities include a mandatory conversion condition, which forces conversion if the underlying stock price is above some threshold level and the issuer chooses not to redeem the security for face value.
Net	Yield expressed, exclusive of any available franking credits or tax-deferred benefits.
Reference Rate	Typically a floating reference rate (e.g., 90-day BBSW) used to reference the periodic coupon payment of a hybrid security. The reference rate is generally applied at the beginning of a distribution period for the upcoming distribution. Also referred to as the market rate.
Reset	For certain hybrid securities, on a reset date, the issuer may reset certain terms including the next reset date, the dividend/distribution rate, the conversion discount and the timing of frequency of dividend/distribution payments. Resets may mean significant change to the terms of the hybrid security and as a result investors may or may not accept such new terms. Further, the issuer may elect to redeem or to exchange the hybrid security. As such, Morningstar has a conservative approach to treating resets and considers it as a probable maturity. In tables and abbreviations, we use "Reset" to refer to any step-up, mandatory conversion, call or other pseudo-maturity event.
Running Yield	The hybrid's annual coupon payments expressed as a percentage of the market value of the security.
Step-up	For certain hybrid securities, the margin above the reference rate may be increased or stepped-up at a predetermined date upon the occurrence or non-occurrence of a certain event (e.g., non-conversion at a specified date).
Tax Deferred	The distribution of certain hybrid securities may have a tax-deferred component (may be less than 100%), which allows the distributions to be tax deferred over a certain period. The tax-deferred distributions are not assessable to Australian income tax upon receipt for most investors, but instead reduce the cost base of the security for capital gains tax purposes and as a result defer tax until the disposal of the security. Securities offering a tax-deferred component may give rise to tax benefits. Changes to tax legislation may have the effect of reducing the tax-deferred component of distributions. Investors should seek professional taxation advice in relation to dealing in these securities and their individual situation.
Time to Maturity/Reset	The time expressed in number of years from now to a reset date, conversion date, step-up date and/or maturity date, where on such date, either the terms of the security may change or the security may be repurchased, redeemed, exchanged or converted.
Trading Margin	In simple terms if an issuer already had securities on issue, they could expect any new securities with \$100 face value to trade close to the trading margin. The Trading Margin of a security s is the effective margin at which s trades; it is the margin which a new security n with face value of \$100 would need so the sum of the discounted cash flows of n equal the discounted cash flows of s assuming redemption of both s and n at the pseudo-maturity date of s . The calculation is grossed up for franking where appropriate.
VWAP	The average of the daily volume weighted average sale price of ordinary shares sold on ASX during the relevant

	period subject to specific terms and adjustments of the relevant hybrid security offer.
Volatility	The degree to which the price of a security tends to fluctuate.
Yield to Reset/Maturity (YTR/YTM)	The hybrid's internal rate of return to reset, step-up or other pseudo-maturity event.
pcp	previous corresponding period
p.a.	per annum
Capex	Capital expenditure
YoY	Year on Year
HoH	Half on Half
QoQ	Quarter on Quarter