



# Product Review

## Exchange Traded Bond Units

ISSUE DATE: 17-02-2015

### Key information

INVESTMENT TYPE	EXCHANGE TRADED BOND UNITS IN THE <b>AUSTRALIAN CORPORATE BOND TRUST</b> . XTBs ARE SEPARATED INTO DIFFERENT CLASSES WITHIN THE TRUST. EACH CLASS IS LINKED TO THE PERFORMANCE OF ONE UNDERLYING CORPORATE BOND
RESPONSIBLE ENTITY	THETA ASSET MANAGEMENT LIMITED
SECURITIES MANAGER	AUSTRALIAN CORPORATE BOND COMPANY LIMITED
CUSTODIAN	AUSTRALIAN EXECUTOR TRUSTEES LTD
AUTHORISED PARTICIPANTS	MULTIPLE
MARKET MAKERS	DEUTSCHE BANK
REGISTRAR	REGISTRY DIRECT
UNDERLYING CORPORATE BONDS	VARIOUS COMPANIES THAT HAVE ISSUED CORPORATE BONDS IN THE AUSTRALIAN CAPITAL MARKETS. THE CORPORATE BONDS ARE SENIOR UNSECURED DEBT OBLIGATIONS OF THE ISSUERS
MATURITY DATE	VARIOUS, ACCORDING TO THE PDS
MINIMUM INVESTMENT	THERE IS NO MINIMUM INVESTMENT AMOUNT
LIQUIDITY	XTBs ARE LISTED ON THE ASX
<b>Fees</b>	
SECURITIES MANAGER'S MARGIN	0.40% P.A. TIMES THE NUMBER OF YEARS TO MATURITY. REFLECTED IN THE UNIT PRICE ON THE ASX.
BROKERAGE	AS NEGOTIATED BETWEEN BROKER AND INVESTOR

### What this Rating Means

The 'Approved' rating indicates that Lonsec believes the financial product can generate risk adjusted returns in line with relevant objectives. If applicable, the financial product provides an adequate means for investors to gain exposure to the underlying assets. The rating applies to the PDS dated 2 January 2015.

### Using this Product

**This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.**

- Exchange Traded Bonds Units (XTBs) provide exposure to corporate bonds on an individual basis. That is, there is no pooling of underlying corporate bonds. XTBs are initially available over a number of top 50 ASX listed companies, however there may be additional companies covered by way of new PDS. All coupons paid by the Underlying Corporate Bonds are passed through to investors.
- Once the XTBs are quoted on the ASX, they will be able to be traded, subject to liquidity of the Underlying Corporate Bond. Market Makers may provide bid / offers, similar to ETFs. XTBs are held alongside shares in an investor's HIN in CHESS.
- Investors should note that investment in a small number of XTBs is likely to be far more concentrated than investment in the asset class by way of a bond or fixed interest managed fund.
- XTBs may suit investors seeking:
  - Regular income and capital stability
  - Higher interest rates than term deposits or other cash based products
- Access to a transparent and liquid (subject to the liquidity of the Underlying Corporate Bond) defensive asset class.

### Product risk characteristics

	LOW	MODERATE	HIGH
CONCENTRATION	VARIES ACCORDING TO NUMBER OF INVESTMENTS AND CREDITWORTHINESS OF UNDERLYING CORPORATE BOND. SEE RISKS ON PAGE 4 FOR MORE INFORMATION		
CREDIT			
INTEREST RATE			
LIQUIDITY			

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the product's asset class and the risks relative to other products in the relevant Lonsec sector universe.

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### Lonsec Opinion of this Product

- XTBs provide a transparent and straight forward means to offer retail investors a choice of fixed income investments usually only available to institutional investors. In Australia corporate bonds are generally only available in the wholesale market to institutional and professional investors and are traded 'over-the-counter' via banks and brokers, typically with minimum parcel sizes of \$500,000.
- Despite there having been much discussion between market participants over a number of years there has been little action in opening the Australian corporate bond market to retail investors. Lonsec considers XTBs to be a legitimate means of eliminating some of the barriers faced by retail investors seeking to access the Australian corporate bond market and believes this initiative is a significant development.
- The Underlying Corporate Bonds are all companies from the ASX top 50 (initially) but it is important to realise the Securities Manager has not selected these corporate bond issuers after undertaking any form of credit analysis or assessment of ability to pay coupons or repay face value as these obligations fall due. **Ultimately, investors must be comfortable with this risk and make their own assessment of the issuers to meet their obligations.**
- Lonsec notes that securities trade on the ASX on the basis of price, whereas corporate bonds are more meaningful when thought of in yield terms. The process for determining the yield of the XTBs and comparing to alternative yield products is somewhat clumsier than trading equities on the ASX.
- The Directors, executives and key shareholders of the Securities Manager have backgrounds suited to offering investments of this type. They have extensive experience and expertise across investment banking, funds management, financial product manufacturing and distribution and exchange operations, for equity and fixed income markets both domestically and internationally.

### Relevant Parties

The Securities Manager, Australian Corporate Bond Company Limited (ACBC), undertakes overall product management of the Trust. The Underlying Bonds are selected by the Securities Manager.

Global Bond Exchange Pty Limited (GBX) is the parent holding company of ACBC. GBX has no other business interests at present and employs the management team of ACBC. GBX shareholders are the board of directors (>70%) and a small group of individual shareholders (<30%). GBX / ACBC is likely to pursue its own AFSL arrangements in 2015.

The Responsible Entity is Theta Asset Management Limited, a wholly owned subsidiary of Theta Asset Group Pty Ltd. Theta Asset Group Pty Ltd is also the parent entity and related party of Valuestream Investment Management Limited. The Responsible Entity has a conditional right of indemnity out of the assets of the Trust. This right entitles the Responsible

Entity to pay expenses of the Trust that the Responsible Entity has reasonably incurred in the administration of the Trust, directly from the assets of the Trust. These expenses are generally met from the Securities Manager's Margin.

The Custodian is Australian Executor Trustees Ltd (AET). Theta has appointed AET to act as an independent custodian to hold the assets of the Trust. AET is one of Australia's largest and oldest licensed trustee companies and is a member of the IOOF Holdings Limited.

**The Registrar** is Registry Direct, who provides share registry services to listed and unlisted companies, fund managers and product issuers. The Registry provides distribution and tax statements at the end of each financial year.

### How does the Product Work?

The Securities Manager has arranged for the Responsible Entity to issue the XTBs in a registered managed investment scheme, which gives retail investors economic exposure to Underlying Corporate Bonds, usually only available to the wholesale market.

The Underlying Bonds for each Class, together with any distributions or coupons in respect of those Underlying Corporate Bonds, are held by the Responsible Entity in separate sub-trusts. The Underlying Corporate Bonds are held by the Custodian in Austraclear. In legal terms, the Custodian will be the legal title holder of the Underlying Bonds on behalf of the Responsible Entity who will be the beneficial holder of the Underlying Bonds on behalf of investors.

Custodial fees and all other fees or charges levied by all service providers are paid by the Responsible Entity and Securities Manager out of the Securities Manager's Margin.

### Distributions

Payment of any distributions or coupons will be made to the Responsible Entity via the Custodian and is held in the relevant sub-trust. The Custodian pays out distributions as soon as practicable after they are received via the Registry (expected to be within 10 business days). The distributions are fixed and do not vary like dividends attached to shares.

### Underlying Corporate Bonds

The Underlying Corporate Bonds are issued by either ASX listed entities or a subsidiary of an ASX listed entity, who are subject to continuous and periodic disclosure requirements under the ASX Listing Rules and the Corporations Act.

The Underlying Corporate Bonds are **senior unsecured bonds** issued by these ASX listed entities or subsidiaries and are themselves generally not quoted on the ASX. Instead, the Underlying Corporate Bonds are issued in the wholesale market and are traded between participants in that market.

The Underlying Corporate Bonds typically have fixed payments or coupons over the life of the bond and a repayment of principal at maturity. Coupons can be fixed rate where the investor receives the same cash

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amount on every coupon date, or floating rate, where the investor receives a fixed margin above a reference rate, such as the bank bill rate.

The prices of XTBs will fluctuate based on a wide range of factors including:

- interest rate movements and market expectations of future interest rates;
- movements in credit spreads;
- changes in the creditworthiness of the issuer;
- the remaining life of the bond;
- supply and demand factors.

The corresponding yields for the XTBs can be calculated on [www.xtbs.com.au](http://www.xtbs.com.au) using the price displayed on the ASX.

### Fees

If a 5 year Underlying Corporate Bond is trading at \$100, the XTB price would generally be \$102, reflecting the number of years to maturity multiplied by the Securities Manager's Fee of 0.40% (pro rata for part of a year). If the investor sold the XTB after 2 years and the underlying bond is trading at \$100, the price of the XTB would be approx. \$101.20, reflecting that the investor has only paid for 2 years of fees, and had an effective refund of the remaining 3, all other factors remaining constant. The Securities Manager will make a daily announcement via the ASX and XTB website showing the closing yield for the Underlying Corporate Bonds for the previous business day. Investors may view the announcements at the ASX's website at [www.asx.com.au](http://www.asx.com.au) by searching the ticker code 'YTM'.

The current list of Underlying Corporate Bonds is:

ASX CODE OF XTB	BOND ISSUER	ASX CODE OF ISSUER	COUPON & MATURITY
YTMAZJ	AURIZON NETWORK PTY LTD	AZJ	5.75% 28 OCT 2020
YTM BHP	BHP BILLITON FINANCE LTD	BHP	3.75% 18 OCT 2017
YTM CWN	CROWN GROUP FINANCE LTD	CWN	5.75% 18 JUL 2017
YTM DXS	DEXUS FINANCE PTY LTD	DXS	5.75% 10 SEP 2018
YTM GPT	GPT RE LTD AS RE FOR THE GENERAL PROPERTY TRUST	GPT	6.75% 24 JAN 2019
YTM IPL	INCITEC PIVOT LTD	IPL	5.75% 21 FEB 2019
YTM LLC	LEND LEASE FINANCE LIMITED	LLC	5.50% 13 NON 2018
YTM LL1	LEND LEASE FINANCE LIMITED	LLC	6.00% 13 MAY 2020
YTM MGR	MIRVAC GROUP FINANCE LIMITED	MGR	5.75% 18 SEP 2020
YTM NVN	NOVION RE LTD AS RE FOR THE NOVION TRUST	NVN	5.00% 19 DEC 2019
YTM SCG	RE1 LTD AS TRUSTEE AND RE OF WESTFIELD RETAIL TRUST 1	SCG	5.00% 23 OCT 2019
YTM SGP	STOCKLAND TRUST MANAGEMENT LTD AS RE FOR THE STOCKLAND TRUST	SGP	5.50% 6 SEP 2019
YTM SG1	STOCKLAND TRUST MANAGEMENT LTD AS RE FOR THE STOCKLAND TRUST	SGP	8.25% 25 NOV 2020
YTM TLS	TELSTRA CORPORATION LIMITED	TLS	7.75% 15 JUL 2020
YTM WES	WESFARMERS LIMITED	WES	6.25% 28 MAR 2019
YTM WE1	WESFARMERS LIMITED	WES	4.75% 12 MAR 2020
YTM WOW	WOOLWORTHS LIMITED	WOW	6.00% 21 MAR 2019

The Securities Manager intends to expand this list over time and will do so via new PDS.

### Taxation

The difference between the purchase and sale price of XTBs should generally be recognised on capital account. CGT discounts should generally be available for holding periods of over 12 months.

Coupons received by investors should be included as assessable income in the year of receipt.

**These comments constitute 'General Advice' only and Lonsec advises potential investors to consult a taxation specialist before making a decision to invest (or not to invest) based upon these taxation considerations. Investors should refer to the Prospectus for further information.**

### Liquidity

XTBs may be traded on the ASX, although investors should have a medium to long term investment time horizon.

XTBs trade intra-day at prevailing market prices in a similar manner to other securities on the ASX. Listing or trading on a stock exchange does not guarantee that a liquid market exists for XTBs.

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### Risks

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An investment in the Product carries a number of standard investment risks associated with domestic and international investment markets. These include economic, political, legal, tax and regulatory risks. These and other risks are outlined in the Prospectus and should be read in full and understood by potential investors. Lonsec considers the major risks to be:

#### **Credit risk**

Investors are exposed to the creditworthiness of the Underlying Corporate Bonds and can suffer losses (possibly all) if an Issuer defaults on its obligations. Liquidity risk – the market for bonds is generally less liquid than equities for the same issuer. Although listed on the ASX, there is no guarantee that liquidity is provided to investors at a price acceptable to them. The appointment of a Market Maker may assist in providing liquidity but is limited to the extent that there is liquidity in the wholesale market for the Underlying Corporate Bonds.

#### **Inflation risk**

High inflation rates have the potential to reduce the purchasing power of XTBs.

#### **Securities Manager risk**

If the Securities Manager becomes insolvent an administrator / liquidator may be appointed. In this case the Responsible Entity would appoint another Securities Manager.

#### **Early Redemption risk**

If investors wish to redeem prior to the Maturity Date, losses may be realised, particularly where interest rates have risen or the creditworthiness of the issuer has deteriorated since purchase.

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Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

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#### Date prepared

February 2015

#### Analyst

Michael Elsworth

#### Release authorised by

Elizabeth Newman

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