Morgans IN ALLIANCE WITH CIMB

Fixed Income Education

Simple Corporate Bonds

Portfolio diversification using senior ranking Corporate Bonds

Building a diversified fixed interest portfolio is easily achieved using the extensive range of ASX listed securities available. These include:

- Exchange-traded Government bonds
- Senior (Simple) Corporate Bonds
- XTBs (Exchange-traded Corporate Bond units)
- Subordinated Corporate Bonds/Notes
- Bank & Insurer Subordinated Bonds/Notes
- Bank & Insurer Capital Notes (hybrids)

In an environment of historically low interest rates, investors seeking income have tended to focus on higher yielding securities, namely Subordinated Notes and Capital Notes issued by APRA regulated banks and insurers. While these offer very attractive distribution rates, under APRA requirements these securities must be able to be converted into ordinary equity or even written-off in certain circumstances. Additionally, in the case of Capital Notes, distributions are paid solely at the discretion of the Board.

Why invest in Senior Bonds?

Senior Bonds offer investors a much higher level of security. This is because they rank for payment ahead of lower ranked instruments and in the event of default, rank ahead of all obligors except secured creditors and those preferred by law. They cannot be converted into equity and the payment of interest or principal (at maturity) is not discretionary; non-payment is an event of default.

Capital Structure

DEBT	Senior secured debt
	Senior unsecured debt
	Subordinated debt
HYBRID	Capital Notes
	Preference shares
EQUITY	Ordinary equity

SOURCE: MORGANS

Simple Corporate Bonds

One form of senior debt available to investors is ASX listed Simple Corporate Bonds. The form of these bonds must follow strict guidelines set by ASIC and offer a standardised reporting format so that investors can easily monitor the ongoing performance and credit worthiness of the issuer. Recent issuers of bonds under this regime include Australian Unity (ASX: AYUHB) and PEET (ASX: PPCHA).

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Simple Corporate Bonds characteristics

These are the basic characteristics of bonds issued in this format:

- Fixed maturity date;
- No conversion to equity;
- They must be legally enforceable debt obligations;
- Coupons are paid in cash (no franking); and
- Coupons can be fixed rate or floating rate.

ASIC prescribes specific company financial metrics that must be published at issue and updated through the bond's life, these are:

- Gearing ratio (Total Liabilities) / (Total Equity)
- Interest Cover ratio (EBITDA) / (Net Interest Expense)
- Working Capital ratio (Current assets) / (Current liabilities)

Why do companies issue Simple Corporate Bonds?

There is a natural life cycle of funding arrangements as companies grow. Generally, companies start out using bank funding as their sole source of debt financing. As they grow, they will then typically look to diversify their sources of funding beyond the banks. For very large ASX listed companies they will generally be able to access the unlisted wholesale bond markets domestically and overseas. However, there are many smaller companies that are growing strongly and will also seek diversified sources of funding. For some, a sensible alternative will be to look to the ASX listed fixed interest market. Issuing bonds on the ASX will also allow them to extend the maturity profile of their debt beyond the very short funding terms (1-3 years) available via the banks.

What are the benefits to investors?

ASX listed bonds provide investors with the following benefits;

- **Diversification** – higher ranking and different credit exposures to the concentrated banking and insurance sectors;
- **Transparency** – Issuers are subject to ongoing disclosure requirements;
- **Simplicity** – ASIC prescribed ratios allow for easy monitoring of the issuer's financial health;
- **Price discovery** – investors can look to ASX for valuation of their holding; and
- **Liquidity** – ASX listing provides investors with a tradable market.

Building a Portfolio

Senior ranking Corporate Bonds offer an ideal opportunity to diversify income portfolios. Morgans can build individually tailored portfolios that include debt and hybrid fixed interest securities. We can also design **debt only** portfolios that are tailored to your objectives and risk profile. For more information please review our publication *What are Fixed Interest Securities?* or speak with your Morgans adviser.

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