

Rate swings a hazard of buying notes

DIY super

John Wasiliev

Thousands of Woolworths small shareholders, including many with do-it-yourself super funds, were reported to be disappointed by the meagre allocation they received in the company's recent hybrid investments offering.

Ending with a very modest \$2100 investment when you may have been willing to invest \$10,000 or more, highlights that participating in public investment offerings can be a frustrating experience for small investors.

If it is any comfort to those investors – like the reader who wrote to this newspaper on behalf of his DIY fund stating that as a holder of 2000 Woolworth shares he felt insulted by the 21 Woolworths \$100 notes he received – fewer than 500 investors ended up with more than 1000 notes. Not that such an investment is a small holding given 1000 notes represents an investment of \$100,000.

While the vast majority of investors – just under 98 per cent of the 20,300 note holders – fell into the less than 1000 notes group, the average holding of this group of 126 notes suggests applying for them through a broker offer was a better proposition that going through the shareholder offer.

A small positive that many



Paying more for notes will reduce their yield.

Photo: DANIEL MUNOZ

commentators missed for shareholders who were scaled down was that Woolworths paid interest on the application money sent back.

Although their applications were also reduced, clients of brokers who participated in the offering clearly received more notes than those who applied through the shareholder offer. In fact, Woolworths shareholders who applied for both the broker offer and the shareholder offer ended up only with the broker offer allocation. Any extra application under the shareholder offer was not accepted.

Another reader writes that given

the notes are listed on the stockmarket, surely investors who want more can buy them through the Australian Securities Exchange. Yet another DIY fund reader asked whether the notes were worth buying through the market?

That's a good question, says Gavin Madson, director of infrastructure and fixed income research with broker FIIG Securities. While the notes can certainly be bought through the market, he says, they are trading at a premium due to the attention they have attracted. The notes listed at \$103 and have been trading at this

level, a \$3 premium to their \$100 face value.

Madson says there will certainly be some investors, most likely professional traders, who deliberately bought Woolworth notes via the broker offer or the offer to financial institutions with a view to selling them in the immediate post-listing period to investors who missed out.

These professionals knew that at the \$100 offer price and paying 3.25 per cent above the bank bill rate they were likely to be considered an attractive investment with a good chance of listing at a premium.

This set the notes up for the trading strategy described as scalping, where mostly professional investors are content to make even a small profit over a short period, such as a few weeks, by aiming to sell their holdings straight away.

Virtually all the notes that are likely to be offered through the market over the next month or two are expected to come from short-term professional traders looking to cash in on this post-listing demand.

Investors who buy notes at higher prices need to be aware that this will reduce the yield of the investment over the entire term. At \$103, instead of 3.25 per cent above the bank bill rate, the return reduces to about 2.6 per cent.

For this reason, anyone interested in buying more notes might do well to wait until trading settles down,

says Madson. Or they could consider other fixed interest-paying, more attractive yields. One such is the Origin Energy offering, which is similar to the Woolworths notes, but offering a return of 4 to 4.5 per cent above the bank bill rate.

With investments like the Woolworths notes, investors need to be aware that when they mature and are redeemed, the most they will get is \$100 per note. The expected redemption date for the Woolworths note is November 2016.

As far as income returns are concerned, the most investors will get is the fixed 3.25 per cent above the bank bill rate based on the \$100 offer price, which becomes less if you pay more for the note.

While the margin offered by Woolworths is fixed, the bank bill rate is a fluctuating amount because bank bill rates change in line with movements in the interest rate market where the present trend is far from certain.

An example of potential interest fluctuations is shown in the income returns of the predecessor to the latest Woolworths notes.

The Woolworth notes version 1 were launched in mid-2006 and over the next five years paid income on a quarterly basis at annualised returns that ranged from just under 9 per cent in mid-2008 to just over 4.1 per cent a year later when interest rates fell dramatically in the wake of the global financial crisis.