

Extracting cash and creating wealth through protected lending



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Many investors who have their own share portfolio look for the opportunity to protect the capital value of their shares or even leverage their shares to increase their exposure to the stock market, particularly in times of high market volatility. With the right financial advice, using your current share portfolio as security for a loan or just protecting the capital value of your shares is now possible with the Protected Loan.

Introducing Joshua

Joshua is a marketing manager in a large consumer goods company. Back in September 2005 Joshua invested \$100,000 into two shares he believed would deliver strong long term capital growth potential – BHP Billiton (BHP) and Rio Tinto (RIO). The prices at which Joshua purchased these shares were \$20.20 and \$40.55 respectively.

The strategy

Joshua's shares have increased significantly in value since he purchased his shares. His original \$100,000 share holding now has a current market value of approximately \$177,446.

Recently, the market has become volatile and Joshua is worried that the BHP and RIO share prices may lose value over the next 18 months. Joshua is keen to continue to hold his shares but would like to put in place a level of protection at current prices.

A summary of Joshua's holdings are detailed below:

Initial Holdings (September 2005)	BHP	RIO
Investment amount	\$50,000	\$50,000
Purchase price per share	\$20.20	\$40.55
Number of shares	2,475	1,233
Current Holdings (August 2011)	BHP	RIO
Price per share	\$37.53	\$68.58
Market value	\$92,887	\$84,559
Capital growth	\$42,887	\$34,559

Joshua decides together with his financial adviser to explore his options. After discussing his financial situation and investment objectives, his adviser recommends a five year Protected Loan. By doing this Joshua is able to roll his shares into a Protected Loan, protect his shares at current prices and use the unlocked funds to diversify his portfolio.

The terms of Joshua's Protected Loan are as follows:

Portfolio Value	\$177,446
Loan Amount / unlocked funds	\$177,446
Protection / gearing level	100%
Tax rate	41.5%
Term	5 years
Interest Rate	13.02% p.a.
Interest rate type	Variable (paid monthly in arrears)
Estimated deductible rate	8.80% p.a.
Portfolio	BHP Billiton, Rio Tinto

Note: The portion of the interest that is not deductible is added to the cost base of either the put option or the securities acquired.

Establishment costs are not included in these figures.

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By using the Share Roll In feature available under the Protected Loan, Joshua has been able to:

- protect his BHP and RIO shares at current market prices of \$37.53 and \$68.58 respectively;
- remove the risk of any future potential margin calls;
- unlock a cash amount of \$177,446 (being 100% of the sum of the current market value for both share holdings);
- claim a potential tax deduction in relation to the interest expense on his Protected Loan. Joshua must use the unlocked funds for income producing purposes;
- retain beneficial ownership of his BHP and RIO shares without triggering a capital gains tax event; and
- continue to be entitled to receive ordinary dividends and potential franking credits

The result

Let's assume Joshua's Protected Loan has performed as follows over the five year term:

ASX Code	No. of shares	Initial share value	Initial market value	Share price at maturity	Market value at maturity	Unrealised Gain/Loss	Protected Loan value at maturity
BHP	2,475	\$37.53	\$92,887	\$54.50	\$134,888	\$42,001	\$134,888
RIO	1,233	\$68.58	\$84,559	\$61.60	\$75,953	(\$8,606)	\$84,559
Total			\$177,446		\$210,841	\$33,395	\$219,447

As the value of the RIO shares is less than the loan amount at maturity, Joshua can hand his shares back to Commonwealth Bank as repayment of the loan. Commonwealth Bank will acquire the shares at the original amount of \$84,559, meaning Joshua has not suffered from the adverse move in the share price. Joshua can choose to:

- sell the BHP shares and receive the profits less brokerage;
- repay the loan and take delivery of the BHP shares; or
- roll the shares into a new Protected Loan.

Getting the right advice

As with any financial strategy, using a Protected Loan to borrow and invest is not without its risks. One of the key risks of using a Protected Loan is that your return could be negative, after taking into account the performance of your shares and borrowing costs over the term. That's why it's important to read the Product Disclosure Statement to ensure you are fully informed.

Call us on 1300 786 039 for more information about how your clients can extract cash and create wealth through protected lending to help achieve their goals.

¹The Share Roll In feature is not available to Superannuation funds.

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