



The Australian Sharemarket – a wealth of opportunity

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Two key factors often cited for successful wealth creation have been investing for the long term and using borrowed funds to increase the size of the investment(s) and thus potentially the return. While many trustees of Self-Managed Super Funds (SMSF) take a long-term approach when investing for retirement, they have previously been prohibited from borrowing (except under certain circumstances) within the context of an SMSF.

Investments by superannuation funds into Instalment Warrants have been a long standing practice that is widespread in the market. As a result of APRA's and the ATO's recent review on Instalments, the Government has amended the Superannuation Industry (Supervision) Act 1993 to allow regulated superannuation funds to continue to invest in traditional Instalment Warrants. Fund investments in Instalment Warrants must still comply with other superannuation rules, including, for example, they must not result in fund assets being subject to a charge.

Westpac SFIs are an alternate way of gearing into the stock market. They allow investors to buy Australian shares and units (collectively called 'Securities') of

many leading Australian listed entities in two simple payments or instalments':

- First Instalment – Payable by all applicants to Westpac for an interest in the Underlying Security, including entitlements to any dividends, capital gains (or losses) and potential franking credits
- Second Instalment – otherwise known as the Completion Payment or Loan Amount. It is an optional payment if the investor would like to take ownership of the Underlying Security.

Dividends paid by the security are used to reduce the Loan Amount. In addition, interest on the loan is capitalised, or added onto the Loan Amount automatically. Although dividends are not received in cash, SFI holders are entitled to any potential franking credits distributed with the dividends.

SFIs allow investors to increase their exposure to the equity market and potentially create wealth quicker. Furthermore, there is no need to make periodic payments or be inconvenienced with margin calls during volatile periods.

Case Study 1

Increasing Share Market Exposure

Super Choice has allowed John and his partner Julie the opportunity to consolidate their super and start an SMSF. Part of the fund's strategy is to invest \$100,000 into Westpac 10 year SFIs with a view that the underlying shares will appreciate at a rate of 10% p.a. over an 8.4 year period (when the SFI's reach their Maturity Date).

Together with their financial planner, John and Julie put together the following portfolio of 10 year SFIs:

Table 1

ASX Instalment Code	Number of Warrants	Instalment Price	Initial Investment Amount	Underlying Share Price	Equity Exposure
AMPSWD	3311	\$3.02	\$10,000	\$8.09	\$26,786
ANZSWE	968	\$10.33	\$10,000	\$25.00	\$24,200
BHPSWE	469	\$21.32	\$10,000	\$36.92	\$17,315
CBASWE	498	\$20.08	\$10,000	\$48.82	\$24,312
NABSWD	836	\$11.96	\$10,000	\$32.80	\$27,421
QBESWD	691	\$14.48	\$10,000	\$28.02	\$19,362
SUNSWD	1681	\$5.95	\$10,000	\$14.93	\$25,097
TCLSWB	2469	\$4.05	\$10,000	\$6.46	\$15,950
TOLSWE	2079	\$4.81	\$10,000	\$10.95	\$22,765
WOWSWD	664	\$15.06	\$10,000	\$28.30	\$18,791
			\$100,000		\$222,000

As can be seen in Table 1, \$100,000 invested in SFIs will give Total Equity Exposure of \$222,000. The initial Completion Payment (i.e. Loan Amount) is \$159,924.

Outcomes

Table 2 below shows the simulated economic gain/loss on the initial investment of \$100,000 for the corresponding growth rates. Using Westpac dividend forecasts and assuming a constant interest rate over the period, the estimated Completion Payment at maturity is \$133,698.

Table 2

Capital Growth p.a. over 8.4 Years to Maturity	Portfolio Value [A]	Instalment Value [(B)=(A-\$133,698)]	Gain/Loss on Initial Investment [B-\$100K]	Total Percentage Gain/Loss
-5.00%	\$144,351	\$10,653	-\$89,347	-89%
0.00%	\$222,000	\$88,302	-\$11,698	-12%
5.00%	\$334,320	\$200,622	\$100,622	101%
10.00%	\$493,969	\$360,271	\$260,271	260%
15.00%	\$717,297	\$583,599	\$483,599	484%

If John and Julie's assumptions are correct and the portfolio of stocks appreciate at 10% p.a. for 8.4 years, the portfolio of SFIs would have an approximate economic value of \$360,271 (i.e. Portfolio Value less the estimated Completion Payment at maturity). This economic gain of \$260,271 (i.e. \$360,271 less the initial investment amount of \$100,000) is inclusive of all dividends over the term received on the initial outlay of \$100,000.

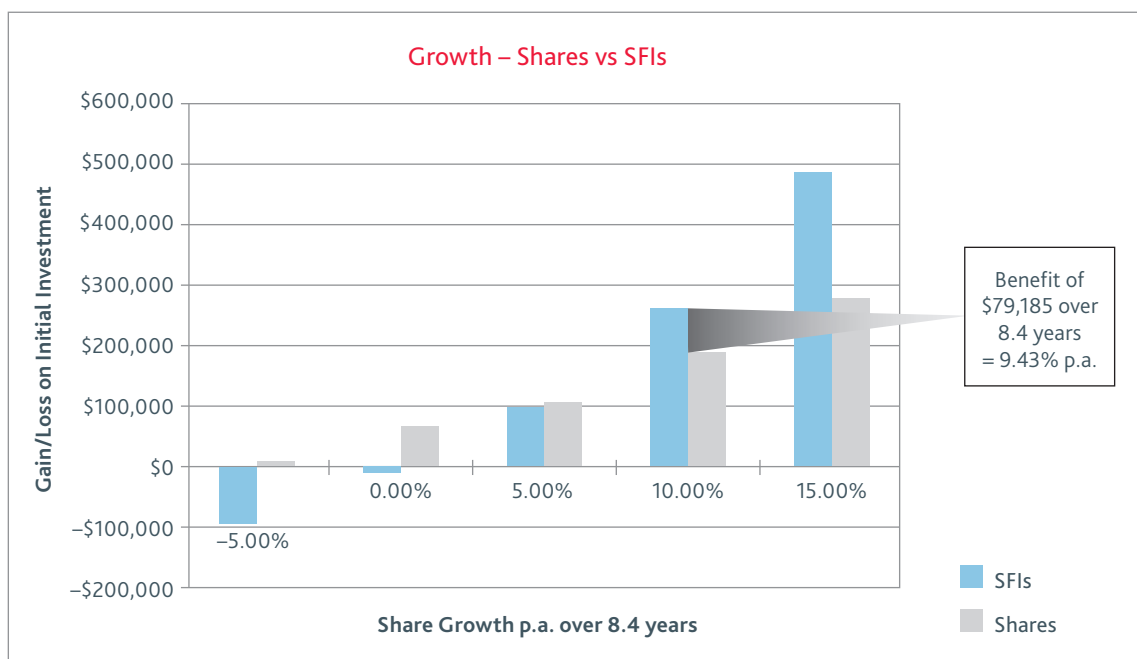
If the SMSF invested \$100,000 into the same portfolio without any gearing, the return would be as follows:

Table 3

Capital Growth p.a. over 8.4 Years	Portfolio Value [A]	Dividends Received [B]	Gain/Loss on Initial Investment [(A+B)-\$100K]	Total Percentage Gain/Loss
-5.00%	\$65,016	\$58,602	\$23,618	24%
0.00%	\$100,000	\$58,602	\$58,602	59%
5.00%	\$150,578	\$58,602	\$109,180	109%
10.00%	\$222,484	\$58,602	\$181,086	181%
15.00%	\$323,071	\$58,602	\$281,673	282%

Comparing Tables 2 and 3, we find that if John and Julie are correct and the portfolio grows at an average rate of 10% p.a., they will potentially benefit by an additional \$79,185 (i.e. \$260,271 less \$181,086) by having invested in SFIs.

These growth comparisons between shares and SFIs are shown in the graph below.



Interestingly the benefits of SFIs are not just limited to capital growth.

Enhanced Income and Other Potential Benefits

Holders of SFIs receive dividends from the underlying securities which are used to reduce the Loan Amount. Holders may also be entitled to receive the associated franking credits attached to those dividends.

As an SFI holder, the SMSF's assessable income will generally include an amount equal to the cash dividends paid on the underlying securities, increased by the amount of franking credits attached to those dividends, even though the SMSF does not physically receive the dividends.

An SMSF may potentially be entitled to offset its tax payable for an income year by the amount of the franking credits it receives during the year. If the franking credits the SMSF is entitled to claim for a particular year exceed the amount of tax payable for that year, the SMSF may potentially be entitled to receive a tax refund.

Case Study 2

Enhanced Income and Potential Tax Outcomes

Continuing on from Case Study 1, John and Julie are interested in comparing the potential cash flow and tax outcomes for an SMSF entering into an SFI portfolio against a direct share investment over an 8.4 period (assuming the tax rate for a superannuation fund remains at 15% and the fund makes no taxable contributions during the period).

Table 4

	SFI Portfolio	Share Portfolio
Forecasted Assessable income	Total	Total
Dividend estimates	\$132,165	\$58,602
Franking credit	\$46,370	\$19,360
Potential Interest Reimbursement	\$4,182	\$0.00
Total income	\$182,717	\$77,962
Allowable tax deductions		
Interest rate amount	\$108,006	\$0.00
Deductible Borrowing Fees*	\$3,248	\$0.00
Total Deductible expenses	\$111,254	\$0.00
Taxable income/(tax loss)		
Income less allowable deductions	\$71,463	\$77,962
(Tax payable)/Tax credit		
Tax payable	(\$10,719)	(\$11,694)
Franking credit*	\$46,370	\$19,360
(Total tax payable)/Total tax credit	\$35,650	\$7,665

Prices as at 08 February 2008 (Total tax payable)/Total tax credit \$22,189/\$5,848.

*Relates to a 2% upfront commission payable to the planner.

Table 4 above outlines the indicative cashflows for both investments over an 8.4 year period. An investment into the SFI Portfolio may generate excess franking credits of \$35,650, that over the 8.4 year period may be offset against tax payable on other assessable income of the SMSF or refundable over the period. In contrast, a direct share investment would generate potential excess franking credits of just \$7,665.

If John and Julie were to make taxable contributions to their SMSF during the 8.4 year period, the potential excess franking credits generated under the SFI portfolio may potentially offset the tax payable on total taxable contributions of \$237,667 (i.e. \$35,650/15%) over the 8.4 year period, assuming the tax rate for a superannuation fund remains at 15% during the period. In comparison, a direct investment would offset the tax payable on total taxable contributions of just \$51,100 (i.e. \$7,665/15%).

Important Information: Westpac Banking Corporation ABN 33 007 457 141, AFSL 233714 ("Westpac") is the issuer of the Westpac Self-Funding Instalments ("SFI"). A product disclosure statement ("PDS") is available for the Westpac SFI. A copy of the Westpac SFI PDS and a copy of Westpac's Financial Services Guide can be obtained by calling 1800 990 107 or visiting westpac.com.au/structuredinvestments. You should obtain and consider the PDS before deciding whether to acquire, continue to hold or dispose of the Westpac SFI. This information has been prepared without taking account of your objectives, financial situation or needs. Because of this you should, before acting on this information, consider its appropriateness having regard to your objectives, financial situation or needs. The taxation position described is a general statement and should only be used as a guide. The positions described do not constitute tax advice nor promote that those tax positions will arise for Investors. The tax positions described are only indicative of current tax laws and their interpretation. Information for trustees of SMSF. In certain circumstances, under guidelines issued by the Australian Prudential Regulation Authority and Australian Tax Office (the "Super Regulators"), Instalments can be an eligible investment for self-managed superannuation funds when acquired using a Cash Application or on market. However, trustees of super funds should read the guidelines before deciding to invest. Under the law, superannuation fund investors are subject to restrictions on the types of investments they can make and activities they can undertake, including restrictions on borrowing and charging their assets. The Super Regulators require trustees of superannuation funds to consider an investment in the context of the superannuation fund's particular investment strategy and to ensure they are familiar with the risks involved in investing in Instalments, have appropriate risk management procedures in place prior to making the investment and disclose to members the details of the fund's investment strategy. Superannuation fund trustees will need to ensure that they have the power to acquire Instalments or other derivatives, ensure they have sufficient liquidity in the superannuation fund to pay the Completion Payment, or have an investment strategy in place that contemplates the superannuation fund electing not to make the Completion Payment, and therefore not acquiring the underlying Security. The information in this newsletter is factual only. It does not constitute financial product advice. Before acting on this information you should seek independent financial and taxation advice to determine its appropriateness to your objectives, financial situation and needs. The information is current as at February 2008. WIBED619 (03/08) 129513



Setting your cash free for diversification

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With any personal investment strategy you embark upon it is prudent to consider diversifying your investment portfolio. One possibility to consider is using Westpac Self-Funding Instalments (SFI) to free up cash from concentrated share holdings for diversification while maintaining exposure to your original investment. Investors' exposure to equities has increased dramatically. Many have switched from the Australian property market toward equity, and increasingly employees are being paid part of their salary or bonuses in shares and utilising dividend reinvestment strategies to further increase their holdings. A popular method of releasing funds from a concentrated equity holding without triggering a CGT event is through a strategy using Westpac SFIs known as cash extraction.

The Cash Extraction Strategy

Please note this strategy is not available to Self-Managed Super Funds.

For the purpose of illustrating the cash extraction strategy let's look at an investment in 8,000 BHP shares with no other equity exposure. Cash extraction involves converting the BHP shares into

the equivalent number of Westpac SFIs. You maintain exposure to the price movements in the BHP shares and release cash for other investments without triggering a CGT liability. The cash received must be used for business or investment purposes.

The Cash-Back Amount

The amount of cash received is simply the difference between the share price and the Westpac SFI price. The higher the SFI gearing level the more cash you get back. Westpac SFIs are available in a range of gearing levels, principally between 40 and 60 per cent. The cash back can be used to purchase alternate SFIs for diversification, reinvested in the same series to increase exposure, or for other business or investment purposes.

Dividends, Distributions and Franking Credits

The dividends and other distributions paid by the underlying BHP shares are used to reduce the Loan Amount and are not passed through to the individual investor. This means at maturity the investor may only have a small amount to pay or nothing at all to take delivery of the underlying BHP shares.

Cash Back Amounts for Primary Market Applications*

BHP Share Price	\$36.92	\$36.92	\$36.92	\$36.92	\$36.92
SFI Code	BHPSWA	BHPSWZ	BHPSWB	BHPSWC	BHPSWE
Completion Date	30/06/2009	30/06/2009	30/06/2016	30/06/2016	30/06/2016
SFI Price	\$30.81	\$26.07	\$27.14	\$23.97	\$21.32
Completion Payment (Loan Amount)	\$6.47	\$11.45	\$11.99	\$15.59	\$19.66
Cash Back Amount Per Share	\$6.11	\$10.85	\$9.78	\$12.95	\$15.60
Cash Back Amount (8,000 BHP Shares)	\$48,880	\$86,800	\$78,240	\$103,600	\$124,800
Total Number of SFIs if Cash Back Amount is Reinvested	9,586	11,329	10,882	12,322	13,853

*Prices as at 08 February 2008.

Income analysis based on 8,000 BHP Self-Funding Instalments*

SFI Code	BHPSWA	BHPSWZ	BHPSWB	BHPSWC	BHPSWE
Total Dividends to Completion Date**	\$7,140.22	\$7,140.22	\$51,067.41	\$51,067.41	\$51,067.41
Franking Credits	\$3,060.10	\$3,060.10	\$21,886.03	\$21,886.03	\$21,886.03
Total Taxable Income†	\$10,249.82	\$10,249.82	\$74,982.90	\$74,982.90	\$74,982.90

Income analysis based on BHP Self-Funding Instalments with Cash Back Amount reinvested into the same series*

SFI Code	BHPSWA	BHPSWZ	BHPSWB	BHPSWC	BHPSWE
Total Dividends to Completion Date**	\$8,555.77	\$10,111.45	\$57,827.46	\$78,656.58	\$88,429.60
Franking Credits	\$3,666.76	\$4,333.48	\$24,783.20	\$33,709.96	\$37,898.40
Total Taxable Income†	\$12,281.84	\$14,515.02	\$84,908.77	\$115,492.41	\$129,842.26

* Prices as at 08 February 2008.

**The gross estimated dividends and franking credits are estimates of Westpac based on past dividend/distribution paying periods of the underlying security and are not guaranteed. Whilst Westpac has taken every effort to ensure that the assumptions upon which it has based these estimates are reasonable, the estimate may be affected by assumptions being or becoming inaccurate and by known or unknown risks and uncertainties. Dividends, distributions and franking credits (if any) ultimately declared in relation to the above securities may be different to those set out above. You should also ensure that you are entitled to franking credits.

† The Total Taxable Income figure for Self-Funding Instalments includes reimbursement of part of the interest prepayment.



Benefits

Exchanging fully paid BHP shares into Westpac SFIs affords investors many benefits including:

- maintaining exposure to price movements in BHP Shares;
- dividends are used to reduce the Loan amount, and
- potential franking credits continue to be received;
- releasing cash for other investments thus being able to further diversify a portfolio;
- Capital Gains Tax liabilities are avoided;
- no margin calls;
- no obligation to make the completion payment.

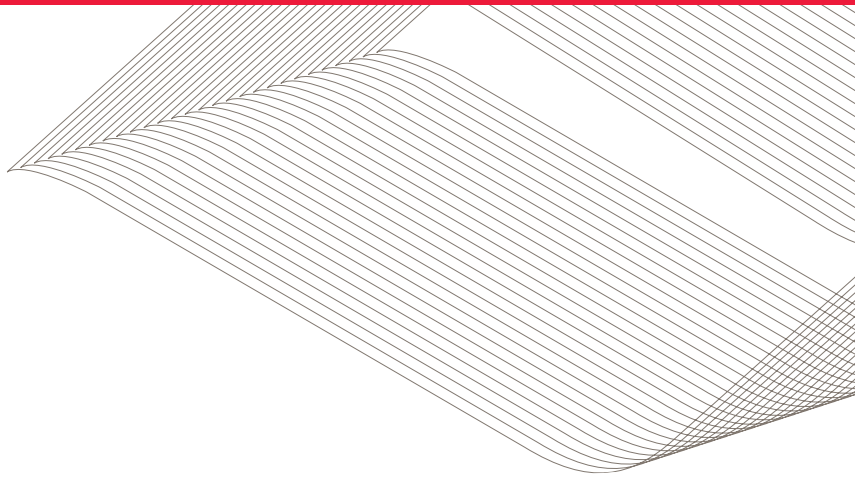
Risks

Westpac SFIs come with the risks inherent in the underlying shares as well as the risks of gearing, including:

- interest amounts which are greater than dividends paid by the Underlying may result in the Loan Amount increasing;
- a decrease in the underlying share price is likely to cause the SFI price to fall at a faster rate than for the underlying share;
- any rise in interest rates will cause the cost of funding to rise;
- if you wish to acquire the underlying shares, you can only repay the Loan Amount on the Annual Interest Date which is 30 June each year.

In Summary

When shares have performed well, investors have traditionally been left with few options to enable them to crystallise the gains without incurring associated tax liabilities. The SFI cash extraction strategy enables certain investors to access the equity in their portfolio without triggering a CGT liability. The multiple series of SFIs offered by Westpac provide investors with a choice of gearing levels to suit their own risk appetite, as well as a wide range of underlying shares for diversification purposes. Investors are also able to increase their exposure to the underlying share for the same initial investment.



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