

AUSTRALIAN

RESEARCH

MANAGED INVESTMENTS ANALYSIS

RBS Self Funding Instalment Warrants

May 2009

Instalment warrants providing geared exposure
to a selection of ASX-listed shares

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Australian Managed Investments

Structured Products

Note: This report is based on the RBS Self Funding Instalments Final PDS, dated 5 February 2009, together with other information provided by RBS Group (Australia) Pty Limited as at May 2009.

RBS Self Funding Instalment Warrants

Instalment warrants providing geared exposure to a selection of ASX-listed shares



Offer Overview

Product Summary

RBS Self Funding Instalment Warrants (*SFI Warrants*) are a series of ASX-listed warrants issued by RBS Group (Australia) Pty Ltd (*RBS*). Each SFI Warrant provides a leveraged exposure to one of a number of issuer-approved ASX-listed equities through a limited-recourse loan. A monthly reset stop-loss feature ensures that investors never lose more than the initial capital outlay. Through a cash application, SFI Warrants are super-fund-compliant because of the limited-recourse nature of the loan. Starting with a loan-to-value ratio (*LVR*) on issue generally ranging between 50% and 55%, the LVR will fluctuate throughout the investment term. Investors are required to provide up-front cash or equity to match the prevailing LVR ratio at the time of application for the first instalment. Each SFI Warrant has a maturity period of 10 years from the issue date; however, a second and final instalment payment (*completion payment*) can be made at any stage throughout the investment term to transfer ownership of the underlying security to the investor. Early expiry will also be triggered if a stop-loss level is breached, with any remaining value returned to the investor. Any dividends paid over the investment term will be credited to the outstanding loan balance rather than paid in cash to investors. Investors will be entitled to any franking credits. Secondary market buying or selling of the SFI Warrants is facilitated via their ASX listing.

Offer Details

Offer Period	Open during investment term
Issue Date	5 February 2009
Maturity	10 years*
Min. Investment	A\$10,000 per warrant (only for cash applications to RBS)
Liquidity	ASX-listed, with RBS Equities Australia as market-maker. Also, a completion payment can be made at any time.
Distributions	None

*Maturity date is 10 years from the issue date or upon a completion payment or a breaching of a stop-loss level. Also, if the loan amount reduces to zero during the investment term, RBS will transfer legal ownership of the underlying securities to investors and trading in the warrants will cease.

Warrant Basket Risk/Return Profile



*Any dividends paid will be credited to the outstanding loan balance rather than paid in cash to investors.

Fees (paid to advisors), incl. GST

Up-front ¹	Typically, range is 0.55% to 1.10%
Ongoing ²	0.0% p.a.

Note: The above represent the advisor fees payable by investors. Actual advisor fee levels are subject to the commercial relationship between investors and advisors.

¹All up-front fees are paid by the investor. The up-front fee relates to the borrowing fee on the loan amount. Whilst the fee is charged by RBS, the amount (if any) is determined by the advisor. The up-front fee, as a percentage of total capital exposure, will vary based on the prevailing LVR. There is no upper limit on the borrowing fee. However, typically up-front borrowing fees range between 1.1% and 2.2% (incl. GST) on the loan amount. Figures in the table above show this range on an equivalent total capital exposure basis assuming an LVR of 50%.

²An ongoing fee is paid by RBS and not by the investor. RBS will pay 0.275% (incl. GST) on the loan amount.

Investment View

Investor Suitability

SFI Warrants are a suitable investment for individuals and self-managed superannuation funds seeking a leveraged exposure to Australian equities. Given the risks of a stop-loss event, investors should be comfortable with the possibility of losing their initial investment. To mitigate this risk, Aegis considers a portfolio allocation to a basket of SFI Warrants as a preferred investment strategy. Given the leveraged nature of the investment, we view the warrants as suited to those investors who have a medium to high tolerance of risk. Gearing may increase if dividends are insufficient to offset interest payments and/or if there is a decline in the underlying security price. Excessive gearing increases the risk of a stop-loss event. Investors therefore should have a positive view on the underlying securities selected.

Recommendation

The Aegis rating for SFI Warrants relates to the product structure only. It does not relate to the underlying securities investors may select.

Investors should note that the performance will be a function of the underlying security. Aegis has assigned SFI Warrants a **Recommended** rating. Aegis views SFI Warrants as a simple, transparent and convenient investment instrument providing leveraged exposure to Australian equities. A basket of SFI Warrants should be viewed as an investment allocation in a portfolio context.

The investment opinion in this report is current as at the date of publication. Investors and advisers should be aware that over time the circumstances of the issuer and/or product may change which may affect our investment opinion.

For Advisers Only

SWOT Summary

Strengths

- The limited-recourse nature of the loan means that SFI Warrants are super-fund-compliant (upon cash application) and also provide investors with the opportunity to leverage their equity investment without putting the other portfolio assets at risk.
- Structure is simple and transparent. SFI Warrants do not include the use of options, therefore, eliminating higher option costs associated with volatile market conditions.
- Investors require only a portion of the value of the securities up-front. There are no margin calls during the investment term and there is no obligation to pay the outstanding loan amount. A stop-loss event ensures that investors do not lose more than their initial investment.
- Investors may exit early by making a completion payment, at which point ownership of the underlying securities will be transferred to the investor without triggering a capital gains tax (CGT) event.
- ASX listing provides investors with the flexibility to trade SFI Warrants at any time during ASX-trading hours.

Weaknesses

- If a stop-loss event occurs, the underlying securities are sold in a down market and investors are not able to participate in any security price recovery. Aegis acknowledges that in instances when the share price does not recover, a stop-loss event protects investors from incurring losses greater than their initial investment.
- An investor's ability to decrease gearing to reduce the risk of a stop-loss event is limited to the availability of a more conservatively geared SFI Warrant. This in turn is subject to further issues in this warrant series. Investors wishing to maintain their total capital exposure when converting into a more conservatively geared warrant need to inject additional capital. Any up-front borrowing fee as determined by advisors upon conversion is paid by investors.
- Investors do not have the option of a fixed-rate loan and are, therefore, exposed to the risks of the interest-rate environment.

Opportunities

- Opportunity to benefit from the capital gains and enhanced franking credits of the underlying securities over the investment term. However, in turn, investors may generate a capital loss.
- Investors are able to 'free up' cash and defer a CGT event by converting any shares an investor may own in an approved underlying entity into SFI Warrants.

Threats

- Dividends made by the underlying securities will be used to service the loan, but may not be sufficient to service the interest payments. This may result in gearing rising to excessive levels, which, in turn, reduces security price headroom relative to the stop-loss level.
- Investors are generally not able to participate in the rights issues of the underlying securities. For non-renounceable issues, this will likely result in dilution of an investor's equity, which, in turn, increases the risk of a stop-loss event.
- Excessive volatility in the underlying security price increases the risk of breaching the stop-loss level.
- Changes to tax law may adversely impact the product.

Product Fees (paid by investors)

	Product	Sector Avg. ¹
Base Fees, % of Assets		
Up-front ²	1.10	2.0
Ongoing	0.00	1.8
Exit	0.13 ³	0.2
Average, p.a.	0.13	2.1

¹Sector average not directly comparable as some of the SFI Warrant fees are imbedded in the variable interest rate.

²Up-front borrowing fee typically ranges between 1.1% and 2.2% (incl. GST) on the loan amount. The product fees in the above table assume the upper end of the typical range and are based on an LVR of 50%. Actual fees may be less. Investors may also purchase warrants via the ASX in which case investors incur a brokerage fee on the warrant value.

³SFI Warrants do not have an exit fee but investors incur brokerage costs if warrants are sold on market. Brokerage costs are charged as a percentage of warrant value. The brokerage fee in the above table is assumed at 0.25% at an LVR of 50%.

Total Fees, % of Expected Total Return*

Up-front	1.1	2.9
Ongoing	0.0	14.5
Exit	0.1	0.2
Total	1.2	17.6

*Based on an average return of 10% p.a. over 10 years.

Product Costs

Costs incurred by investors include any up-front borrowing fee charged by RBS and a variable interest rate on the loan amount. The borrowing fee will only be applicable at an advisor's discretion. If buying or selling through a broker, usual brokerage cost is incurred. The interest amount is calculated and capitalised on a daily basis. The current rate is 7.9% p.a. of the value of the outstanding loan; however, the rate may change. This equates to an effective annual rate of 8.2%.

Costs included in variable interest rate

The variable interest rate can be affected by, among other things, the RBA cash rate target; interest rate levels in the money market; costs in market-making by RBS for SFI Warrants; the volatility, liquidity and costs associated with the purchase of the underlying securities; risk management costs; and resourcing costs.

Fee Commentary

The product fees are largely dependent on the up-front borrowing fee, which investors pay. A borrowing fee is charged by RBS, but is only applicable at an advisor's discretion. If investors choose to convert into another SFI Warrant, this may attract any up-front borrowing fees, as determined by advisors. The product structure eliminates higher option costs associated with volatile markets.

The interest rate on the loan appears to be comparable to market rates. We note the loan has limited recourse, and, as such, the rate incorporates the benefit of this feature compared to recourse loan products. The daily frequency of capitalising interest means investors will incur a greater interest charge compared to one that is capitalised monthly.

2. Structure

Product Overview

SFI Warrants are issued by RBS Group (Australia) Pty Ltd, a wholly owned subsidiary of the Royal Bank of Scotland plc. Each SFI Warrant provides a leveraged exposure to one of a number of ASX-listed securities approved by the issuer from which investors can select. The approved list can be viewed at www.rbs.com.au/warrants.

Owing to higher option costs as a result of volatile market conditions, the warrant structure removes the use of options. Each warrant has been issued at an LVR generally ranging between 50% and 55% of the initial value of the underlying security. The LVR fluctuates throughout the investment term as a result of movement in the underlying security price and net changes in the outstanding loan amount.

Under the structure, investors make an up-front cash or equity contribution (*first instalment*) to match the prevailing LVR ratio at the time of application. RBS provides the loan to the investor and ABNED Nominees Pty Limited (the *Security Trustee*) holds the underlying securities on trust on behalf of the investor. The loan amount will vary daily, as an interest amount will be added daily to the loan amount.

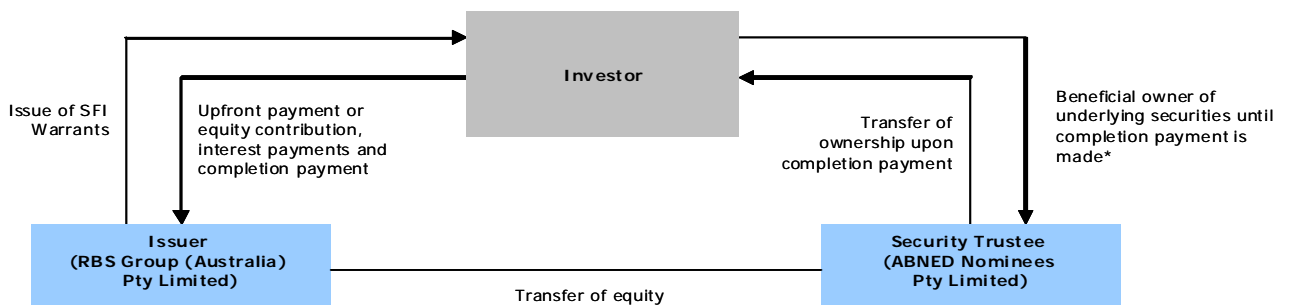
SFI Warrants feature a monthly reset stop-loss level, which ensures the value of the warrant to the investor can never be negative. The stop-loss level is set at a certain level above the outstanding loan amount (currently 10%). A stop-loss event is triggered if the price of the underlying securities is less than, or equal to, the stop-loss level. A trigger results in an early expiry of the SFI Warrant and any remaining value (*RV*) is paid to the investor.

If no stop-loss event is triggered, SFI Warrants mature 10 years from the issue date. However, investors may exit early by making a completion payment, at which point ownership of the underlying securities will be transferred to the investor. Any cash dividends made by the underlying securities will be credited to offset interest payments, with any surplus used to reduce the principal. While investors do not directly receive cash dividends, investors are entitled to any franking credits distributed.

Upon maturity, investors have four options: (1) make the completion payment and take ownership of the securities; (2) roll into a new series of SFI Warrants, if available; (3) sell on market; or (4) take no action in which case RBS will direct the Trustee to sell the underlying securities and return an Assessed Value Payment (*AVP*) to investors.

Aegis strongly encourages investors to avoid taking no action, as this will incur a significant penalty as well as the risk of receiving no AVP. Investors wishing to sell on market are reliant upon RBS making a fair market in the warrants. Representatives from RBS have indicated that they endeavour to ensure sufficient liquidity and a fair market for the life of the warrants.

Investment Structure



* Investors are the beneficial owners until such time as a completion payment is made and ownership of the securities is transferred to the investor. As the beneficial owner, investors are not entitled to take any legal action regarding the underlying securities, as the legal title is held by the Security Trustee.

Key Exposure

Underlying Exposure:	Each SFI Warrant provides exposure to a single underlying ASX-listed security. Investors may choose to purchase a basket of SFI Warrants, based on their own selection criteria, in order to gain a diversified exposure across a number of ASX-listed entities.
FX Exposure:	None, although the underlying entities may have FX exposure.

Exit Details

Exit Facility:	Investors should view SFI Warrants as a long-term investment with a maturity date of 10 years from the issue date. However, investors can terminate SFI Warrants and obtain ownership of the securities at any time up until maturity by making a completion payment. Alternatively, investors may roll into a new series of SFI Warrants, if available. In the event of no action by the investor, the Trustee will sell the underlying securities and distribute Assessed Value Payment. Investors may also choose to exit at any time by selling their warrants on the ASX.
Issuer Early Redemption:	The occurrence of a stop-loss event will result in the early termination of SFI Warrants at which point an RV is determined. Investors will be able to sell back to RBS any positive RV in SFI Warrants. If the remaining value is zero or negative, investors will lose their initial investment and not receive anything back. Aegis notes that if the RV is negative, RBS incurs the shortfall and not the investor. RBS may also nominate an early expiry date upon the occurrence of an extraordinary event or when RBS is entitled to exercise its Security Interest, as defined in the PDS and the Trust Deed.

For Advisers Only

Product Leverage

Used: Each SFI Warrant has been issued at an LVR generally ranging between 50% and 55% of the initial value of the underlying security. The loan is sourced from RBS. Gearing is permitted to drift during the investment term, although excessive gearing will ultimately lead to the stop-loss level breach.

Capital Protection

Method: Each SFI Warrant features a stop-loss level to prevent investors from losing more than their initial contribution. At the same time, it protects the issuer against the occurrence of an equity shortfall to repay the outstanding loan amount. The stop-loss level is set at a certain level above the outstanding loan amount (currently 10%) and reset each month. In the event that the stop-loss level is reached, trading in the warrant is halted. An RV is determined after repayment of the outstanding loan amount (and any expenses incurred, although this is generally zero). Any positive RV is returned to the investor. If the RV is negative, RBS incurs the shortfall and not the investor.

Tax

Disclaimer: Tax consequences depend on individual circumstances. Investors must seek their own taxation advice. The following comments are taken from the Product Disclosure Statement (*PDS*) and cannot be considered tax advice.

Capital gains: According to the *PDS*, as a general rule for *CGT* purposes, investors are treated as owners of the underlying securities despite the fact that legal title is with the Security Trustee during the life of an SFI Warrant. No *CGT* will arise when the underlying securities are transferred from the Security Trustee to the investor when a completion payment is made before or at the maturity of SFI Warrants. If the securities are sold after transfer to the investor, the investor will likely be eligible for the full *CGT* discount (33.3% for super funds and 50% for individuals and trusts) if the underlying securities are held for greater than 12 months (including the period the SFI Warrants are held). In the event a completion payment is not made and the securities are sold by RBS as a result, or if the warrants are sold on the *ASX*, a *CGT* event will arise and will be incurred by the investor, although the *CGT* discount provision will apply if the warrant is held for greater than 12 months.

Distributions: Dividends paid by the underlying securities over the investment term will be assessed in the year they are earned, even though they are not received as a cash dividend directly by the investor. Instead, any cash dividends paid will be used to reduce the outstanding loan amount.

Interest deductibility: Interest payments paid to RBS as a consequence of acquiring a warrant will likely be deductible in the year incurred. Fees will also likely be tax deductible in the year they are incurred.

Legal Structure

Wrapper: Instalment Warrant

Security Trustee: ABNED Nominees Pty Limited

Offer Document: The *PDS*, dated 5 February 2009, has not been lodged with the Australian Securities Investment Commission (*ASIC*) and is not required by the *Corporations Act* 2001 to be lodged with *ASIC*.

Returns

Capital vs. Income: SFI Warrants provide a combination of capital and income returns. Capital return is provided through any capital growth of the underlying securities over the investment term. Income is provided through any dividends paid by the underlying securities. However, investors will not receive any dividends as cash, as these will be credited to the outstanding loan balance.

Income Frequency: Dividends may be paid by the underlying securities; however, these will be credited to the outstanding loan amount on behalf of the investor.

Foreign Currency Risk: None, although the underlying entities may themselves have offshore business exposures.

Investor Leverage

Available: Yes and is compulsory. Each SFI Warrant has been issued at an LVR generally ranging between 50% and 55% of the initial value of the underlying security and will drift throughout the investment term. However, excessive gearing will ultimately lead to the breach of the stop-loss level. Investors may convert their investment into a more conservatively geared SFI Warrant, if available, to avoid a stop-loss event.

Cost (incl. Fees): Costs include any up-front borrowing fee charged by advisors and a variable interest rate on the loan amount. The loan is a variable-rate loan and, therefore, the interest rate may change throughout the investment term. Currently, the rate is 7.9% per annum, capitalised daily. Investors should contact RBS or visit the website (www.rbs.com.au/warrants) to obtain the latest rate. *ASX* trading incurs brokerage fees.

Recourse: Limited-recourse loan. The loan is limited to the recourse of the underlying securities. Should the investment value of the underlying securities fall below the loan amount (including interest), the investor will lose the initial instalment; however, the limited-recourse nature of the loan means the investor will not be required to repay the shortfall.

Risks

Risk: Investments in structured products are subject to a range of risks, including general market risks and risks specific to the product. Refer to pages 16–19 of the *PDS* for a full list of risks associated with this product. Investors should read and understand these risks before investing in the product.

3. Management & Corporate Governance

Corporate Overview

The issuer, RBS Group (Australia) Pty Ltd (*RBS*), is a wholly owned subsidiary of the Royal Bank of Scotland plc. Prior to re-branding in March 2009, RBS was named ABN AMRO Australia Pty Limited, although it remains under the ownership of Netherlands-based ABN AMRO Holdings N.V. On 17 October 2007, ABN AMRO Holdings N.V. was acquired by a consortium now comprising the Royal Bank of Scotland (38%), the Dutch Government (34%) and Banco Santander S.A (28%). ABN AMRO Holdings N.V. is to be integrated into the Royal Bank of Scotland during 2009. Until the integration process is complete, ABN AMRO Holdings N.V. operates as a separately capitalised and regulated entity under the supervision of the Dutch Central Bank.

The RBS Australian business operations are grouped into investment and corporate banking services, retail services and strategic investments. RBS holds a 50% equity stake in ABN AMRO Morgans. ABN AMRO Morgans offers advisory services, stockbroking and wealth management expertise. On 26 February 2009, ABN AMRO Craigs reached an agreement with RBS to buy back its 50% equity stake in the company. Through the agreement, RBS retains a strategic partnership with ABN AMRO Craigs in New Zealand.

Management Team

The Australian management team involved in the product comprises eight members, with the average years of industry experience being around 10 years per team member. Aegis regards the management team as adequately experienced within the industry and as having the appropriate capabilities to manage the product. We note that the management team's involvement is limited, given investors select which SFI Warrants to invest in to achieve their desired underlying security exposure. The team is more focused on facilitating the transactions, providing the financing arrangements and ensuring risks are appropriately managed, particularly through the management of the stop-loss feature. The key team members are summarised in Figure 1.

Figure 1. Key Team Members

Team Member / Position	Experience
Aaron Stambulich Executive Director – Head of Equity Structured Products and Warrants	Mr. Stambulich joined RBS in December 2000 and is responsible for the management of all retail equity derivatives products in Australia and New Zealand. Prior to joining RBS, he worked for Deutsche Bank in London in Global Equity Derivatives, performing pricing and valuation functions during 1998 and 1999. Prior to this, Mr. Stambulich worked for the Commonwealth Dept of Finance in Canberra as a graduate economist, working in expenditure policy branch for two federal budgets.
Michael Igla Associate Director – Equity Structured Products and Warrants	Mr. Igla joined RBS in a structuring and infrastructure role in June 2006. Prior to joining RBS, he worked at Westpac Banking Corporation where he set up and managed the listed product side of the equity derivatives and warrants business. He has 20 years' relevant industry experience.
James Poon Equity Structured Products Manager	Mr. Poon joined RBS in a structuring role in April 2007. Previously, he worked at Westpac Banking Corporation in the Equity Derivatives team. Mr. Poon was responsible for the set up and ongoing management of the Protected Equity Loan business, Structured Equity Solutions and Capital Protected Hedge Fund products.

Source: RBS/Aegis Equities Research

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Information Flow

Upon purchase of an SFI Warrant, investors receive a transaction summary, including a pricing breakdown. During the term of the investment, RBS will issue an annual tax statement to investors. Following the payment of a dividend by an underlying entity's shares, the appointed registrar will send a statement to the investor advising the amount of the cash dividend paid towards the outstanding loan amount and also details of the franking credits (if any) in relation to the dividend paid. Prior to warrant maturity, RBS will issue an expiry notification letter. If a stop-loss event is reached, RBS will send investors a payment advice detailing the determined RV (if any).

The interest rate on the loan is variable and changes daily. RBS will announce the applicable interest rate, and consequently, the outstanding loan amount on its website at www.rbs.com.au/warrants before the open of trading on the ASX each day. RBS will post information about any changes made to stop-loss levels on its website.

All correspondence from the underlying securities will be received by the Security Trustee and will not be forwarded on to the investor. Investors will generally not be able to participate in corporate actions, although, depending on the corporate action, may participate indirectly as deemed by the Issuer. The Issuer will attempt to preserve, as far as reasonably possible, with the consent of the ASX as applicable, the position of both parties in a fair and equitable manner.

In the event of a takeover bid, RBS will not accept a takeover bid and has no obligation to communicate any information it receives to the investor. Under compulsory acquisition, RBS may nominate an extraordinary event (in which case the relevant SFI Warrant may expire) and may substitute the underlying entity's shares.

In the event of a rights issue, investors are generally not able to participate. For a renounceable issue, RBS will sell the rights on market and pass on the economic benefit by reducing the outstanding loan amount. For a non-renounceable issue, no participation will likely result in the dilution of an investor's equity, which, in turn, increases the risk of a stop-loss event.

Investors should refer to sections 8.1 and 8.2 of the PDS, which provide further details on corporate actions and takeovers.

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4. Investment Process

Application Process

Investors lodge an application form, indicating which SFI Warrants they wish to purchase (from the list of approved securities).

RBS will accept applications under one of three different scenarios:

- **Cash application:** Upon receipt and acceptance of the application, RBS will draw down a loan corresponding to the prevailing gearing level of the relevant warrant at the time of application. RBS will use the applicant amount and, together with the loan proceeds, purchase the appropriate underlying securities to place in the Security Trustee. SFI Warrants are then issued to the investor. Part of the applicant amount will be applied towards the payment of any up-front borrowing fee determined by the advisor and charged by RBS;
- **Shareholder application (not available for superannuation entities):** According to the PDS, investors are able to 'free up' cash and defer a CGT event by converting any shares they may own of an approved underlying entity into SFI Warrants. This strategy is known as 'cash extraction'. This is accomplished by transferring the shares held by the investor to the Security Trustee in exchange for cash. RBS will then issue to the investor the equivalent amount of SFI Warrants. The amount of cash returned is equal to the loan amount minus the up-front borrowing fees (if any). Shareholder applicants must use the amount received wholly for business or investment purposes if they wish to claim a tax deduction for the interest on the loan; and
- **Conversion application (superannuation entities should seek own advice):** This application option applies to only those investors who hold a prior series instalment warrant issued by RBS (or by the former ABN AMRO Australia Pty Limited entity) where the underlying securities are held with the Security Trustee. These investors can choose to roll their prior warrant series into SFI Warrants, thus maintaining their leveraged exposure to the underlying securities if on the approved list. Depending on the amount of the outstanding loan payment of the prior series and up-front borrowing fee (if any) payable on SFI Warrants, RBS may either require the investor to make an additional payment or return excess funds to the investor. Aegis notes that there is some uncertainty surrounding whether a conversion application by a superannuation entity might contravene the Superannuation Industry (Supervision) (SIS) Regulations. Superannuation entities should obtain their own advice before investing in SFI Warrants via conversion application.

Given the SFI Warrant series has already been listed on the ASX, investors may also purchase SFI Warrants on the ASX through a broker or a financial advisor.

Product Management Process

Each SFI Warrant has been issued at an LVR generally ranging between 50% and 55% of the initial value of the underlying security. During the investment term, gearing is permitted to drift down or up; however, excessive gearing will result in the breach of the stop-loss level at which point trading in the SFI Warrant is halted. Alternatively, as the share price approaches the stop-loss level, investors may elect to convert to a more conservatively geared SFI Warrant series, if available at the time.

Conversion into another warrant may attract an up-front borrowing fee that investors pay. A borrowing fee is charged by RBS, but is only applicable at an advisor's discretion. Also, conversion into a more conservatively geared warrant will require additional funds from investors if they wish to maintain their total capital exposure. Following conversion, headroom above the stop-loss level increases and, hence, allows increased scope for any further adverse share price movement.

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Investors may also choose to convert their investment into a more highly geared warrant, if available, during the investment term. In this scenario, after satisfying payment of any up-front borrowing fee charged by the advisor, investors may be able to extract some of their invested equity without sacrificing their total underlying capital exposure.

Stop-loss feature

The initial stop-loss level is set before SFI Warrants are issued and are disclosed in Part 1 of the PDS. Throughout the investment term, the stop-loss level is set at a certain level above the outstanding loan amount (currently 10% above) to safeguard both RBS and the investor that the outstanding loan obligation plus any incurred expenses can be met. This feature, along with the limited-recourse nature of the loan, ensures that in a worst case scenario, investors can never lose more than their initial investment.

On the first trading day of every calendar month or such other frequency as determined by RBS, the stop-loss level is updated. The revised stop-loss levels are available daily on the RBS warrants website at www.rbs.com.au/warrants.

The stop-loss level is largely determined by the outstanding loan amount. However, the level above the outstanding loan amount, which is currently 10%, may be influenced by a number of factors, including the following:

- The underlying entity's security price;
- The difference between the outstanding loan payment and the underlying security price;
- The historical volatility of the underlying entity's security price; and
- The estimated size and timing of future dividends applicable to the underlying securities.

If the security price breaches the stop-loss level, trading in the SFI Warrant series is halted. While trading is halted, RBS will sell the underlying securities and will calculate an RV. The RV is calculated as the executed share disposal price minus the outstanding loan amount (and minus any expenses incurred, although this is generally zero). If the RV is positive, the affected SFI Warrant will be reinstated for trading at 2p.m. (Sydney time) on the trading day immediately following the suspension date so that investors can sell their warrants back to RBS for the RV. Trading will continue until close of trading on the following business day before final termination. Otherwise, if investors do not sell their affected warrants back to RBS on market, the RV is paid to the investor within 10 business days.

If the remaining value is zero or negative, the SFI Warrant will terminate after the initial trading halt and investors lose their initial investment and do not receive anything back. Investors do not need to provide any additional funds if the RV is negative and RBS will fund the shortfall.

Loan amount

The loan is limited in recourse to the underlying securities. From the warrant issue date, the loan amount increases on a daily basis by a daily interest amount that is added to the loan amount until and inclusive of the termination or expiry date. The interest amount is calculated on the basis of a variable interest rate, which is 7.9% as at the date of this report. The outstanding loan amount is reduced by the underlying entities' dividends that are paid during the warrant investment term. The dividends are credited towards the loan on the ex-dividend date.

Redemption Process

The underlying securities will be held in a trust by the Security Trustee until the investor undertakes one of the following courses of action:

- **Sell SFI Warrants on the ASX** – Investors can sell their SFI Warrants on the ASX via a stockbroker or a financial advisor up until the close of trading on the warrant expiry date. Investors wishing to sell on market should be aware that there is no firm indication as to how the warrants will trade on the ASX or the level of liquidity. Investors wishing to sell on market are reliant upon RBS making a fair market in the warrants. Representatives from RBS have indicated that they endeavour to ensure sufficient liquidity and a fair market for the life of the warrants;

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- **Completion payment** – This can be done at any time, not just at maturity. The investor pays the outstanding loan amount (and any transfer expenses) and takes ownership of the securities;
- **Roll over into a new series of SFI Warrants at expiry** – This is subject to a new series of SFI Warrants existing at that time; or
- **No Action** – If no action is undertaken by the investor by 5:00p.m. on the expiry date, RBS will direct the Security Trustee to sell the underlying securities. Investors receive back an AVP calculated as $90\% \times (\text{VWAP} - \text{Loan Outstanding})$ (refer to PDS). Investors should note that the underlying security value, in the last two hours of trading on the expiry date, must be greater than the outstanding loan amount by at least 5% for there to be any AVP at all. **Aegis strongly recommends investors avoid taking no action, given the significant 10% charge applied as well as the risk of receiving no AVP.**

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5. Performance Analytics

The series of warrants issued on 5 February 2009 represents the first issue of SFI Warrants. As a result, there is limited performance history for this product.

Accordingly, using the universe of securities within the RBS-approved security list, Aegis has undertaken backdated analysis over a number of different time periods. Sample portfolios are also examined using these backtested data to assess the merits of portfolio diversification.

Owing to a number of limitations (as detailed below), the backtesting and portfolio analysis are not aimed at providing readers an indication of future performance and may not be indicative of how SFI Warrants would have actually performed in the past. The analysis is only targeted at extracting key themes that influence the performance of SFI Warrants using the underlying security price history under different scenarios.

Aegis highlights two key important limitations that investors should recognise when assessing the backtested results and portfolio diversification analysis. These include the following:

- **Survivorship bias in the sample analysed:** The list of approved securities from which the sample was selected generally includes companies that have experienced growth in their business over the past 10 to 15 years. The analysis does not account for companies that, in the past, may have been considered as suitable candidates for the approved security list, but have since failed or experienced significant contraction in size. As a result, the analysis underestimates the number of stop-loss events and overestimates any measure of performance; and
- **Market performance over backtested period:** The market experience included in the analysis features an extended period of growth. Market contraction experience included in the analysis is mainly limited to the period since November 2006. Therefore, the backtested results do not provide an even representation of strong and weak market conditions.

Summary of Results

The key outcomes of the backtesting and portfolio diversification analysis include the following:

- Performance of the underlying securities is the key factor that determines the frequency of stop-loss events;
- The point of time at which the warrants are issued within equity market cycles also has a large bearing on performance;
- Fluctuations in interest rates do not have a material impact on the frequency of stop-loss events, although in a high interest rate environment, there is a notable decrease in the number of occasions where the loan is repaid from dividends during the investment term;
- The degree of out-/under-performance by a basket of warrants relative to a direct investment strategy is largely influenced by the proportion of stop-loss events compared to the number of warrants held within a portfolio. A diversified portfolio of warrants reduces the downside risks as a result of stop-loss events compared to a concentrated portfolio; and
- To further improve the benefits of diversification over a long-term period, an investment in a basket of SFI Warrants should be considered within a larger investment equity portfolio or within a portfolio that also includes a number of other asset classes.

Backtested Analysis

Backtesting was undertaken on securities from the approved RBS securities list that have at least 10 years of price and dividend history. The following assumptions underpin the analysis:

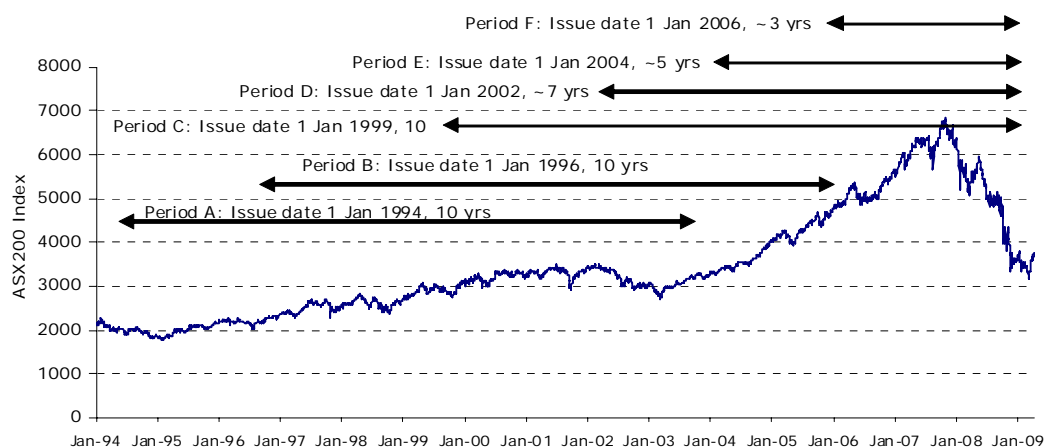
- SFI Warrants are always held to maturity or until a stop-loss event occurs. Aegis notes there are a number of other options available to investors not captured in the backtesting. These include the opportunity to make a completion payment at any time, convert into another available warrant or trade the warrants on the ASX;

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- If the loan is repaid during the investment term, the underlying securities are transferred to but not sold by the investor. Therefore, investors maintain an unleveraged exposure to the underlying securities for the remainder of the investment term;
- An issue LVR of 52.5%, being the mid-point of the general gearing range of 50% to 55% at which SFI Warrants are issued;
- The stop-loss level is always 10% above the outstanding loan amount throughout the investment term;
- The RV is assumed to be zero. This represents a worst case outcome and is not intended to represent an expected RV. Aegis notes that the RV may be positive, which is paid to investors; and
- The variable interest rate history is based on an estimated spread over the 90-day bank bill market rate as published by the Reserve Bank of Australia (*RBA*). Whilst not exactly comparable, the spread estimate has been based on indicator margin loan rates published by the RBA since January 2001.

We have undertaken the backtesting under a number of time periods, as shown in Figure 2, which shows market performance as represented by the S&P/ASX 200 Price Index. Noteworthy, only periods A, B and C represent the full 10-year investment period. Periods A and B do not include the weak market performance since 1 November 2007. Also, period E and in particular, period F, represent periods where the market level was higher at issue date than at the end of the period.

Figure 2. Time Periods Examined in Backtested Analysis



Source: Aegis Equities Research

Four different interest rate scenarios were examined for each time period by variation of the interest rate spread over the 90-day bank bill market rate. The representation of each scenario is explained as follows.

- 200bps spread scenario: Represents a more competitive and/or lower funding cost market environment. The 200bps spread represents the lower spread range of RBA published indicator margin loans over the 90-day bank bill market rate;
- 270bps spread scenario: Represents a base case 'normal market' environment. The 270bps spread represents the mid-point spread range of RBA published indicator margin loans over the 90-day bank bill market rate;
- 340bps spread scenario: Represents a higher funding cost and/or less competitive market environment. The 340bps spread represents the upper spread range of RBA published indicator margin loans over the 90-day bank bill market rate; and

- Higher interest rate scenario: By applying a higher interest rate spread of 500bps on the 90-day bank bill market rate, this represents an extended higher interest rate scenario. With this higher spread, the average interest rate over the 15-year data history is 10.8% per annum. This scenario has been applied to stress-test the backtesting from an interest rate perspective.

For the sample of underlying securities analysed, Figure 3 summarises the number of stop-loss events and the number of occasions the loan is repaid from cash dividends during the investment term for each period and under each scenario.

Figure 3. Summary of Results

Period *	Number of securities in sample	Number of stop-loss events within 10-yr term				Number of occasions loan is repaid during term			
		200 bps spread	270 bps spread	340 bps spread	500 bps spread	200 bps spread	270 bps spread	340 bps spread	500 bps spread
A	15**	0	0	0	0	8	8	8	7
B	18**	1	1	1	1	11	11	11	11
C	24	4	4	4	4	14	14	14	11
D	24	4	4	4	5	3	3	3	1
E	24	0	0	0	0	1	1	1	1
F	24	10	10	10	11	0	0	0	0

*Refer to Figure 2 for details on time period.

**Smaller sample size in periods A and B reflects the lower number of securities from the approved issuer list with price and dividend history of at least 15 years and at least 13 years, respectively.

Source: Aegis Equities Research

When examining the results, readers should note that periods D, E and F are shorter than the 10-year analysis period for periods A, B and C. Periods D, E and F span approximately seven, five and three years, respectively, and have been included to assess performance over a period that includes a larger portion of weak market conditions (that is, period post 1 November 2007). Given the shorter than 10-year data experience in periods D, E and F, the number of stop-loss and loan repayment events recorded may underestimate the potential number over a complete 10-year investment term.

The results illustrate a number of important themes as follows:

- Performance of the underlying securities is the key factor that determines the frequency of stop-loss events. Despite only a three-year time period, period F experienced a high number of stop-loss events as a result of significant falls in underlying security prices after the issue date. The issue date within equity market cycles, therefore, also has a large bearing on performance;
- The change in interest rates under the four different scenarios did not have a material influence on the number of stop-loss events. A marginal impact was experienced in the higher interest rate environment where, in two situations (in periods D and F), the higher amount of interest capitalised resulted in an increase in the loan component of the warrant. This in turn pushed up the stop-loss levels, which, at some point during the investment term, triggered a stop-loss event;
- The number of loan repayment events is strong for periods B and C. This is underpinned by the strong underlying security performance over the investment term, which allowed the equity component in the warrants to increase. This in turn resulted in the enhancement of cash dividends used to offset interest and principal amounts; and
- However, in a higher interest rate environment, Aegis notes the decrease in the number of loan repayment events in periods C and D. This reflects an extended time, beyond the 10-year investment term, needed to repay the loan as a result of the higher interest amounts capitalised during the term.

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Portfolio Diversification Analysis

The occurrence of a stop-loss event results in investors losing their initial investment, if the RV is negative or zero. (Aegis notes that if the RV is negative, RBS incurs the shortfall and not the investor.) Investors are paid any positive RV. Subsequent to a stop-loss event, investors are not able to participate in any recovery of the underlying security price. On the other hand, in instances when the share price does not recover, a stop-loss event ensures that investors do not lose more than their initial investment.

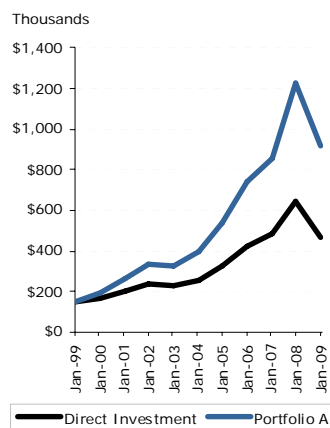
In this section, Aegis examines the merits of portfolio diversification from a risk-return perspective of an initial investment in a basket of SFI Warrants. Aegis notes that this analysis does not attempt to examine the benefits or shortfalls of a stop-loss event based on how the underlying security trades subsequently. Rather, this analysis is targeted only at examining the merits of diversifying an initial investment amount with respect to performance and exposure risk to stop-loss events.

The analysis has been undertaken on the base case interest rate scenario (that is, 270bps spread) over period C. The selection of period C is considered the most appropriate for this analysis, as the time period includes a full 10-year investment term and includes an adequate number of stop-loss events. Aegis has examined three sample portfolios, each including two common stop-loss events over the investment term. The three portfolios represent a range of diversifications: Portfolio A is well diversified with 15 warrants; Portfolio B is moderately diversified and includes 8 warrants; while Portfolio C is concentrated with only 4 warrants.

Aegis highlights that the results in this analysis are for demonstrative purposes only and represent only one of many possible portfolio combination scenarios. Aegis recognises that different portfolio samples will result in different outcomes. Analysis over different time periods also has an important bearing on performance. The performance of the sample portfolios should not be interpreted as representative of expected future performance of equivalent-sized or diversified portfolios. The analysis should only be examined from a portfolio risk perspective.

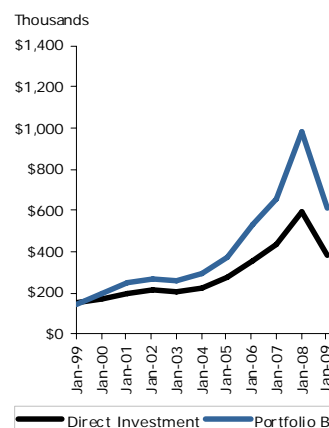
Figures 4, 5 and 6 illustrate the relative performance of each sample warrant portfolio compared to a direct investment in the underlying securities, starting with a hypothetical initial investment of A\$150K.

Figure 4. Well-diversified - 15 Warrants



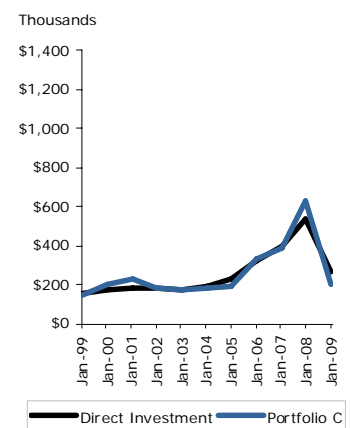
Source: Aegis Equities Research

Figure 5. Moderately Diversified - 8 Warrants



Source: Aegis Equities Research

Figure 6. Concentrated - 4 Warrants



Source: Aegis Equities Research

Based on the inclusion of two common stop-loss events, a well-diversified portfolio performs better than a concentrated portfolio relative to a direct investment in the portfolio's underlying securities. The degree of out-/under-performance by a basket of warrants relative to a direct investment strategy is largely influenced by the proportion of stop-loss events compared to the number of warrants held within a portfolio. The impact of the two stop-loss events is largely diluted in Portfolio A compared to Portfolio C where the two stop-loss events have a more significant impact.

The out-performance of Portfolio C is driven by the relative performance of the remaining two warrants selected within the performance, compared to the remaining 13 warrants in Portfolio A. As a result, the variability of possible performance outcomes for Portfolio C is larger than that for Portfolio A, although the risk of weaker relative performance compared to a direct investment strategy is also larger.

The proportion of stop-loss events within a portfolio, as highlighted in the backtested results, is influenced by market conditions (as well as underlying security specific issues). To further improve the benefits of diversification over a long-term period, an investment in a basket of SFI Warrants should be considered within a larger equity investment portfolio or within a portfolio that also includes a number of other asset classes.

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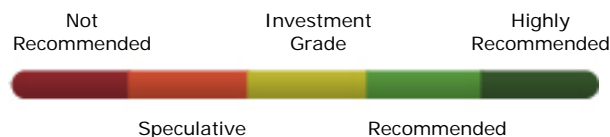
Appendix – Ratings Process

Aegis has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors.

Essentially, the evaluation process includes the following key factors: product management and underlying portfolio construction; investment management, product structure, risk management, experience and performance; fees, risks and likely outcomes.

The Ratings

Our rating is based on the following scale:



Highly Recommended: indicates that Aegis believes this is a superior grade product that has exceeded the requirements of our review process across a number of key evaluation parameters and scored exceptionally in a number of categories. It has an attractive risk/return trade-off; however, we caution that the risk/return trade-off will not be suitable for all investors.

Recommended: indicates that Aegis believes this is an above average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an above average risk/return trade-off; however, we caution that the risk/return trade-off will not be suitable for all investors.

Investment Grade: indicates that Aegis believes this is a suitable product that has met the aggregate requirements of our review process across a number of key evaluation parameters. The product may provide unique diversification opportunities, but may not stand apart from its peers. It has an acceptable risk/return trade-off; however, we caution that the risk/return trade-off will not be suitable for all investors. In the previous five category rating system, this category was termed 'Approved'.

Speculative: indicates that Aegis believes this is a product that has a number of positive attributes; however, there are a number of risks that make investing in this product a speculative proposal. While Aegis does not rule out investing in this product, investors should be very aware of, and be comfortable with, the specific risks. The product may provide unique diversification opportunities; however, concerns over one or more features means that it may not be suitable for most investors.

Not Recommended: indicates that Aegis believes that despite the product's merits and attributes, it has failed to meet the minimum aggregate requirements of our review process across a number of key evaluation parameters. However, this does not mean that the product is without merit.

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The offer of the securities is made in the Product Disclosure Statement (PDS), and anyone wishing to acquire the securities should complete the application form in the PDS.

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