



# Using Shares for Your Income Needs

In simple terms, there are three ways in which you can receive income from your investment portfolio

1. Invest in a portfolio of debt or fixed interest securities.
2. Invest in a property portfolio, either directly or through a managed property fund.
3. Invest in a share portfolio, either directly or through a managed fund.

## How it works: Shares as a source of income

1. Many companies pay income in the form of dividends, so there is a range of shares to consider across many different industries. The amount of income received is typically determined by the company's profits and its desire to distribute that back to shareholders, rather than to retain profits to fund future growth.
2. The level of these dividends can increase over time (unlike most fixed interest investments). There are three reasons for this:
  - Company profits are based on their sales, with prices of their goods and services typically increasing with inflation.
  - Companies that pay good dividends tend to try to maintain their dividends over time to keep their investors happy.
  - Most companies try to grow their profits over time to increase the value of the company for their shareholders.
3. Your capital value is based on a company's market value, which can grow in value over time, beyond the value of your initial investment.
4. Shares can be a tax efficient investment. Dividends attract a tax credit (imputation credit) which is based on the tax paid by the company (for more details, see The dividend imputation system in Australia, on page 4).
  - To properly compare the dividend yield to other income investments the tax credit must be added to the dividend to produce a comparable yield. This is known as a grossed-up dividend.

5. Shares are relatively liquid and can typically be bought and sold through the Australian Stock Exchange. This is not true of many fixed interest and particularly direct property investments.
6. Shares have the additional bonus of the potential for long-term capital growth.
  - Whilst the share price for high quality shares in Australia has historically grown over time, prices can be volatile and investors should take a long-term approach if using shares for income.

Since 1960, Australian company profits have grown at a compound rate of 6.8% p.a. and dividends have grown at 6.5% p.a. Importantly, this rate of growth has exceeded the rate of inflation over the same period (5.3%).

## Why use shares for income: An attractive, growing, tax-effective source of income

While most investors tend to focus on the capital growth aspects of the sharemarket, ***we believe the great untold story of sharemarket investing is the ability of a portfolio of high-quality, dividend-paying shares to provide investors with not only an attractive income stream today, but one that will continue to grow over time. Add to this the tax benefit of imputation credits and you have a compelling income proposition.*** This occurs alongside the long-term capital growth opportunities provided by the sharemarket.

The reason that shares are able to produce a growing income stream over time is that dividends typically increase in line with company profits. While company profits can vary from year to year, overall, they tend to grow over time in line with the growth of the overall economy.

***Many companies in the Australian market have demonstrated an outstanding earnings capacity over long periods of time and this has translated into the ability to pay a strong and growing stream of dividend income through both good and bad times.***

The Perennial Value Shares for Income Trust is all about tapping into this source of tax effective income. The Trust seeks to invest in large, solid companies, with long track records which are "built to last" and have weathered many economic and market fluctuations over time.

# A Practical Example

The tables below show how an investment in ANZ shares in 1990 has outperformed an investment in cash, both from an income point of view and a capital growth point of view. **TABLE 1** shows that on income alone, an investment of \$10,000 in ANZ shares has delivered a better return than an equal \$10,000 investment in 1 year term deposits.

What is most pleasing is the amount of the last annual income payment. Importantly, this is shown on a pre-tax basis to ensure a like-for-like comparison. As can be seen, cash has delivered a return of 6.4% (\$644) on the original investment, whilst the ANZ investment has delivered an impressive annual return of 34.2% (\$3,415) on the original investment.

**TABLE 1**

<b>ANZ vs 1 Year Term Deposit \$10,000 invested from January 1990–December 2008 Dividends/Interest not reinvested</b>		
<b>1 Year Term Deposit (\$)</b>		<b>ANZ (\$)</b>
11,408	Total Income received over the period	22,407
10,000	Value of initial investment as at 31 December 2008	26,875
<b>21,408</b>	<b>Initial investment plus total income received</b>	<b>49,282</b>
644	Amount of last annual payment	2,390
644	Amount of last annual payment (grossed up for tax benefit)	3,415

Having seen the significant difference in the income streams above, this becomes even more pronounced when investors chose to reinvest the income, as shown in **TABLE 2**.

**TABLE 2**

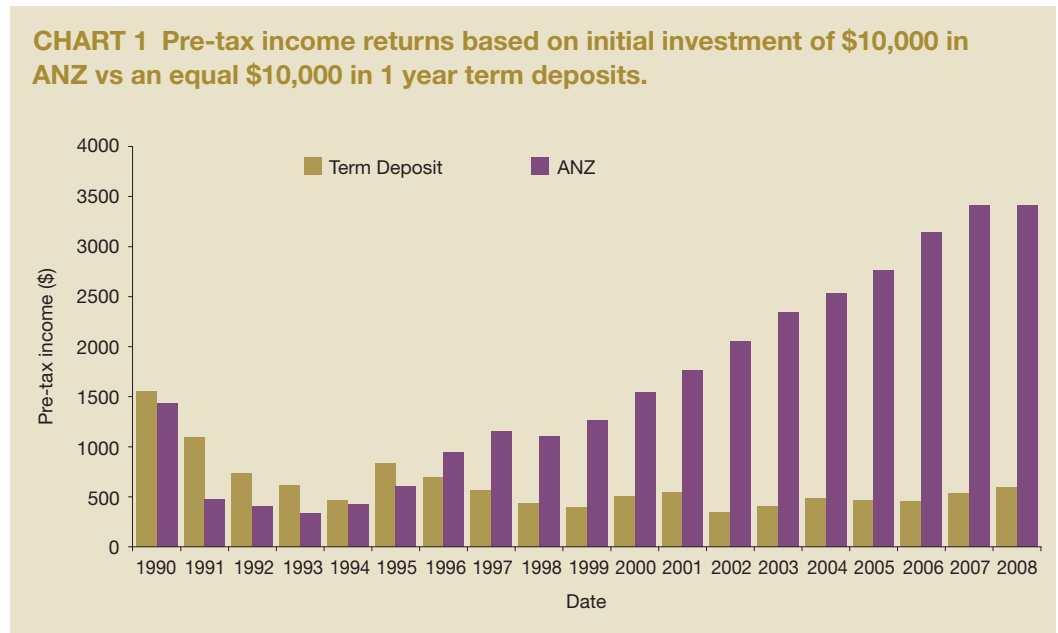
<b>ANZ vs 1 Year Term Deposit \$10,000 invested from January 1990–December 2008 Dividends/Interest reinvested</b>		
<b>1 Year Term Deposit (\$)</b>		<b>ANZ (\$)</b>
20,793	Total Income received and reinvested over the period	50,108
10,000	Value of initial investment as at 31 December 2008	26,875
<b>30,793</b>	<b>Initial investment plus total income reinvested</b>	<b>76,983</b>
1,927	Amount of last annual payment	6,717
1,927	Amount of last annual payment (grossed up for tax benefit)	9,596

**TABLE 2** highlights the significant benefits of compounding, arising from reinvested income. In this example, the effect of compounding results in the final income amount more than doubling.

The results from **TABLE 1** can be shown graphically, as follows:

**CHART 1**

compares respective pre-tax income streams from ANZ and 1 year term deposits, highlighting the significant divergence between the returns.

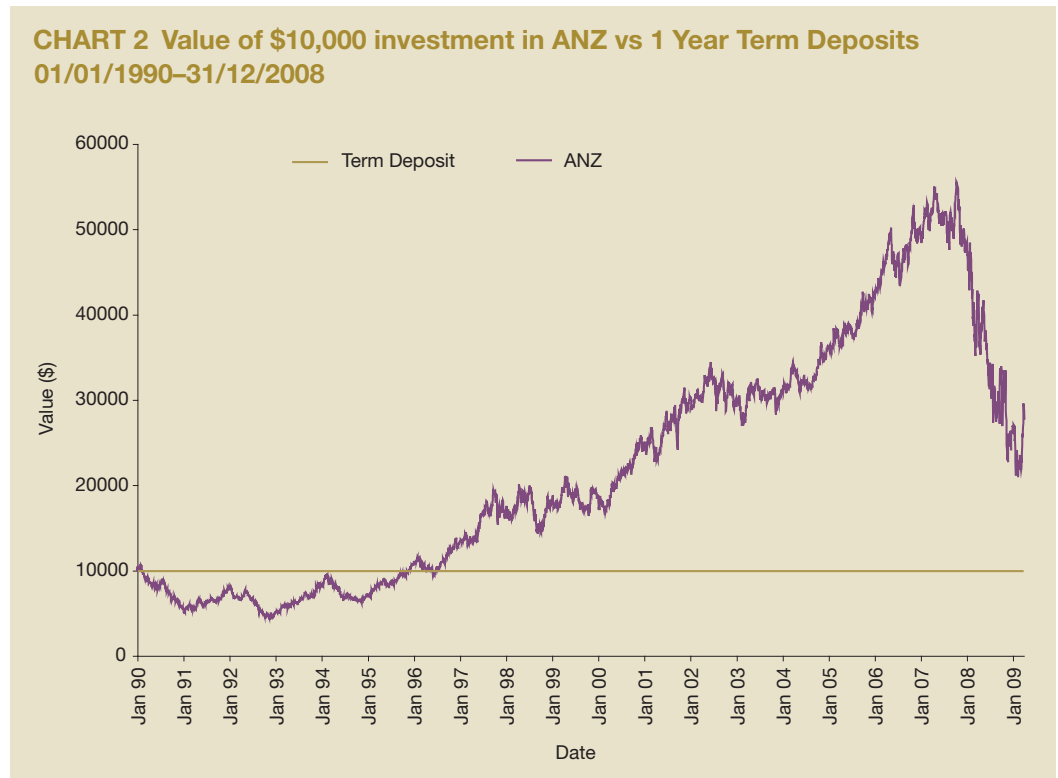


Source: IRESS

Note: ANZ's half yearly dividend payouts were added together to calculate a yearly dividend for the purpose of comparison with the 1 Year Term Deposit figure. ANZ dividends are adjusted figures and are grossed-up.

When investing in ANZ, a shareholder benefits from a regular distribution, as well as capital growth over the long-term. **CHART 2** shows ANZ's investment value over time.

In spite of the recent financial crisis, on capital value alone, the original investment of ANZ shares is still well ahead of the value of the term deposit. Additionally, the investor in ANZ had the benefit of income received (as shown in **CHART 1**).



# The Perennial Value Shares for Income Trust

## Objectives of the Trust

The Trust's objective is to provide investors with an attractive level of tax effective income, to be paid via quarterly distributions. The Trust aims to provide a dividend yield, adjusted for applicable franking credits and before fees, above that provided by the S&P/ASX300 Accumulation Index.

This Trust stands out as an income investment option in that there are very few funds which focus so sharply on the importance of tax effective dividend income streams.

Importantly, this dividend income stream is derived from the cash profits of large, financially-sound companies. It is not dependent on complex financial structuring or high levels of gearing as has been the case in recent years, with many alternative forms of "income-focused" investments.

## The Trust

The Perennial Value Team analyses shares which they believe will offer high levels of grossed up dividends over time, as well as having the ability to provide capital growth over the long-term. Typically, this will include high quality, large-cap, Industrial companies which are built to last. Infrastructure companies and property trusts can also be included in the Trust. However, gearing and valuation issues led the Team to steer clear of these sectors over the past couple of years.

Set out below is a list of some of the companies held in the Trust as at 30 April 2009.

Stock	Year Founded	Market Cap
Westpac Bank	1817	\$47.3 bn
Telstra	1975	\$46.5 bn
CBA	1911	\$43.5 bn
Woodside Petroleum	1937	\$22.8 bn
Wesfarmers	1914	\$11.9 bn
AGL Energy	1837	\$5.8 bn

If you would like more information or an update on the Trust, please visit [www.perennial.net.au](http://www.perennial.net.au). Alternatively, please call 1300 730 032.

## The dividend imputation system in Australia

The system was introduced in 1987 to combat the double taxation of company profits. Up until that date profits were taxed at company level and then again at investor level. Post 1987, in simple terms, investors receive a credit in their tax return for the tax the company has already paid on the dividend that they receive.

If the dividend was fully taxed by the company before it was paid to shareholders the dividend is said to be "fully franked". Dividends can also be partially franked or unfranked if the company did not pay full company tax on that dividend.

Below is an example of a fully franked dividend of \$1,000 where the investor is paying tax at a marginal rate of 15%.

### From the Company's point of view:

<b>1. Taxable Earnings</b>	\$1,428.57
<b>2. Tax at the Company Rate of 30%</b>	\$428.57
<b>3. Dividend Paid (1 – 2)</b>	\$1,000.00

### From the Investor's point of view:

<b>4. Fully Franked Dividend Received</b>	\$1,000.00
<b>5. Grossed up Dividend (4 + 2)</b>	\$1,428.57
<b>6. Tax Credit</b>	\$428.57
<b>7. Tax Payable at 15% (Marginal Rate)</b>	15% of \$1,428.57 less tax credit = \$214.29 – \$428.57 = net tax credit of \$214.28
<b>8. Net Dividend Received (4 + 7)</b>	\$1,214.28

Receiving a franked company dividend is far more tax efficient than receiving moneys from a fully taxable source such as a term deposit.

#### Disclaimer

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