Equity Derivatives: 26th of March 2008
Share Instalments Going Ex-Dividend

What happens when share instalments go ex-dividend? This is a question that we are often asked.

As the holder of a Share Instalment you receive the full ordinary[1] dividend payable on the underlying share. A dividend is defined as a payment made to shareholders out of a company's profits after taxation and prior charges have been met.

The Share Instalment will have the same Declaration Date, Ex-Date, Record Date and Pay Date as the underlying.

- **Declaration date**: The declaration date is the day the company announces their intention to pay a dividend.
- **Last Day to Trade (LDT)**: Date on which Instalments must be held to qualify for dividends, rights or other corporate actions.
- **Ex-Date**: The day on which the Instalment starts trading without the right to participate in the current dividend. In other words, only the owners of the Instalments on the LDT date will receive the dividend. If you purchased Instalments on or after the ex-dividend date, you would not receive its upcoming dividend payment.
- **Pay date**: This is the date the dividend will actually be paid to the Instalment holders.

Generally a company will announce its intention to pay a dividend with its results. The stock will then trade what is known as cum-dividend (with the dividend) for a period of time until the **LDT** (which normally falls on a Friday unless there is a public holiday). As of the Monday the stock will trade **ex-dividend** (without the dividend) and the share price will usually fall to reflect this. About two weeks later on the **Pay Date** investors will actually receive the dividend into their account.

<u>Pricing of a Share Instalment on LDT date and Ex-Div Date</u>

It is important to note that a Share Instalment will go **ex** by the same amount as the underlying, which means that in percentage terms that the Instalment will fall by a greater amount than the underlying.

<u>The Implications of Delta and Share Instalments</u>

In the structuring of Standard Bank Share Instalments we price in some share price protection for the purchaser. What this means is that in a worst case scenario, if a share over which a Share Instalment is issued falls below the exercise price of the Share Instalment, the maximum amount the client will lose is the amount invested in the Share Instalment. This is achieved by including a put option as part of the structure with an exercise price and expiry date the same as that of the Share Instalment. Think of the put option as built-in insurance that limits your maximum potential loss to the amount initially paid for the Share Instalment.
The embedded put results in the net delta of the Share Instalment coming out slightly less than 1 for Share Instalments that are geared two times. In the case of Turbos, their higher levels of gearing mean that the net delta at issue date will be in the region of 0,9 or 90%. In

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Please note that, where a Company declares Extraordinary Dividends, the Issuer will be entitled to treat the declaration of the Extraordinary Dividend as a Potential Adjustment Event and adjust the terms of the Instalment.

terms of Busted[2] Instalments the Delta can be as low as 0.5 or 50% with gearings in excess of 5 times.

Delta is defined as the change in the price of an option for a 1% change in the underlying. It can range from 0 to 1, an option with a delta of 1 will move 1 cent for every 1 cent that the underlying moves, an option with a delta of 0,9 will move 0,9 cents for a 1 cent movement in the underlying. In the case of a Busted Instalment you would get a 0.5 cent move for a 1 cent movement in the underlying.

<u>The practical result of this is that if the share price very quickly recovers and closes at the same price on the ex-date as it closed on the LDT that the Instalment will not move by the same amount as the underlying due to the delta effect of the Instalment. This becomes particularly noticeable in Busted Instalments.</u>

Let's look at an extreme example of a Busted Instalment with a delta of 0.5 where the underlying pays a dividend but closes at the same level on ex-date as LDT.

- On LDT date assume a stock trading at R100 is due to pay an R5 dividend
    - The Instalment listed over the stock is trading at R10 with a delta of 0.5.
- On the Ex-dividend date the stock initially falls by the dividend amount but then recovers to close at R100. The stock is said to have "Held" its dividend.
    - The Share Instalment will close at R7.50 – made of R5 (the ex-dividend Instalment price) + R2.50 being {R5 (the amount that the stock recovered from its ex-dividend price) * 0.5 (the delta of the Instalment)}
- On both securities (the underlying and the Share Instalment) the holder as of LDT would receive the R5 dividend.

Standard Bank publishes a list of all its Share Instalments with their deltas on www.warrants.co.za.

Share Instalment Brochure

[2] An Instalment where the share price is trading close to the Strike price of the Instalment.