ABSA
Corporate & Merchant Bank

Dividend Accruing Retail Trading Securities (“DARTS”)

Also known as “Share Instalments”

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1. Introduction

This guide contains product information that will facilitate better understanding of "*DARTS*" *(Dividend Accruing Retail Trading Securities)*. The document aims to clarify the mechanics of share instalments and how they offer retail traders amplified exposure to movements in shares. This document does not claim to be exhaustive. For more up-to-date information on pricing and current gearing, please contact your financial consultant (stockbroker) or give ACMB Equity Derivatives a ring on our hotline (011 221 9085). Our knowledge and experience is always at your disposal.

2. Basic Principles

DARTS (or "Share Instalments") are increasingly popular investment tools, which have found great success in foreign markets in recent years. DARTS are listed financial options, which allow investors to gear their exposure to equity markets by making only a part payment for shares up front, whilst delaying an optional final payment (or second instalment) until a later date (the expiry date). DARTS effectively allow investors to buy shares for a fraction of the current share price whilst receiving the added benefits of full growth and all ordinary dividend distributions.

In simple terms, DARTS are deep in-the-money call options with a fixed strike or completion payment amount. DARTS enable traders to undertake new investments which essentially gear their exposure to shares. Either way, the strike price (or completion payment) can be paid at any time before the maturity date, with the added benefit of this repayment not being compulsory. Should the share price fall after inception of the trade, the investor can either sell the securities back to the market maker (at the prescribed loss) or allow the DARTS to lapse. Equally, due to the listed nature of these products, should the share price rise after inception of the trade, investors can either sell their DARTS back to the market maker at the realised profit, or choose to exercise the option and take full ownership of the shares. Unlike the case with investments in other leveraged vehicles such as Single Stock Futures (Individual Equity Futures), holders are not subject to daily margin calls.

More conservative investors will warm to the margins of gearing available through trading these products. **Very importantly, holders of DARTS are entitled to full dividend distributions that are paid on the underlying share.**

DARTS are listed instruments, which can be traded like shares on the JSE Securities Exchange through regulated stockbrokers. Absa automatically makes the market in line with intraday share price adjustments, and stockbrokers can buy and sell on behalf of clients at fair market value.

3. Terminology

The Structure
DARTS are liquid securitised options with a long-term maturity (normally 12 months). They are derivative trading securities, issued by an independent party such as a merchant bank or an investment house (the "Issuer" in this case is Absa Bank Ltd) over underlying shares. A DARTS investment entails an initial payment of approximately half the value of a particular share. This enables the investor to gain amplified exposure to that share, as any gains or losses on the change in share price from that point onwards will be referenced to the reduced payment made up front. The optionality of the derivative gives the holder the right, but not the obligation, to make a completion payment at or before the expiry date to effect the purchase of the underlying shares. For investors wishing to capture enhanced returns, Absa DARTS provide leveraged and potentially tax effective exposure.

Essentially, the bank finances the amount of the second instalment (or strike value). This strike price is set at approximately half the value of the market price of the shares at the listing date. When investors buy DARTS, they will initially be geared to approximately two times the movement in the underlying share, and the benefit of this gearing will be factored into the listing price.

When buying Absa DARTS, the investor is effectively paying only a portion of the full purchase consideration for the shares, which nevertheless entitles him/her to the same share gains or losses and dividend benefits as would have accrued had he paid for the shares in full.

Upon initial purchase of DARTS by the investor, Absa will buy the full parcel of shares and hold them on behalf of the DARTS holder. The shares are held until the DARTS expire or the investor sells the DARTS back into the market. All dividends will accrue to the investor.

The Underlying
Most exchange-traded assets are potential underlyings for DARTS: shares, indices, bonds or baskets of stocks. Absa has chosen to list DARTS over a selection of liquid, high dividend yielding ALSI 40 shares.

Expiry date
The expiry date is the last date on which the DARTS may be exercised. All DARTS are **"American"** in style and can be exercised and settled at any time up to and including the expiration date.

Settlement
At the expiry of the call option, the investor will either elect to physically receive the underlying share *("physical delivery")* against payment of the strike price, or he/she will receive an automatic cash payment equal to the price of the underlying share less the exercise price (*"cash settlement" at final intrinsic value*).

4. Pricing Mechanics

To understand how to make money with DARTS, a potential investor must be familiar with the motivations behind buying derivative products, and more precisely "call options".

The purchase of a **call option** is an appropriate strategy for the investor who believes that the price of the underlying share is going to rise, and can be used as a substitute to the direct purchase of the share itself. A call option is the right, but not the obligation, to make a payment to buy a security at or before a predetermined date in the future. At the expiry date, the investor has the option to acquire the shares.

The Leverage Effect
The value of a call option appreciates on a geared basis when the price of the underlying share rises. Gearing associated with DARTS is approximately two times the market movement of the underlying

share at the listing date. An example might look as follows:

Share XYZ is trading at R100 on day one. Assume that the you buy the DARTS listed over the share (with a strike price of R50) at a price of **R55** (R5 of this price represents the interest accrued by the bank to finance the balance of the outstanding purchase price over the period of one year). You now hold the option to pay the strike of R50 at or before the expiry date (which is set as one year from listing date). Should the share price rise by (say) R10 over the period of 36 days, you may then sell your investment back to the market maker at a price of **R64.50** (the 50c decay in the interest component represents the finance charge amortised on a linear basis over 36 days = 0.1*R50*36/365). Through this trade, you have thus effectively geared your exposure to share XYZ to just under twice the movement in the share price. The return on the shares is R10/R100 = 10 percent, whereas the return on the DARTS is (R64.50-R55)/R55 = 17 percent. The added benefit is that the investor would have received **all dividends paid out on the R100 of stock** during the period of his DARTS holding.

NB. We have ignored the marginal effects of changes in volatility and time value inherent to option pricing. This example clearly exhibits the effects of gearing and the financing parameters.

Full Dividend Accrual
When investors buy DARTS, the full shares are purchased and held by the bank, enabling investors to enjoy all the benefits associated with owning the shares themselves. This means that all dividends and share gains (or losses) will accrue to (be incurred by) the DARTS holder as and when paid/realised.

Tradability
Because DARTS are listed on the JSE Securities Exchange, they can be bought and sold just like ordinary shares and the investor is not locked into the investment should things not go as planned. Unlike Single Stock Futures transactions, where the investor is obliged to contract at the agreed price at maturity (and is therefore subject to nightly SAFEX margin calls should the shares fall in value), DARTS traders can merely sell their positions back into the market or choose to walk away at expiry. The logistical benefits of trading at live broadcasted prices on the JSE, as opposed to phoning around for SSF prices, is also a major draw card.

Tax Advantages
Should you buy DARTS on trading account, the premium paid on the investment is tax-deductible against the revenue nature of any profits made on the speculative trade. Absa recommends that potential investors seek independent tax advice before proceeding along such lines.

Releasing committed capital
An advantage of DARTS is that they can be used to temporarily free up capital already committed to equities. An investor may sell existing share holdings, match the original exposure by purchasing a predetermined parcel of DARTS (for a fraction of the market price), and employ the freed up cash in desired short term needs or alternative financial vehicles. Exposure to the original share portfolio can thereby be maintained over the medium term and dividends on the full parcel of the underlying will still accrue to the investor.

No further capital obligation
Investors are not obliged to commit additional capital once the DARTS have been purchased. The DARTS may be **sold** prior to expiry, **exercised** before or at expiry (requiring additional brokerage fees) or merely allowed to **lapse**.

5. ACMB Equity Derivatives Contact Details

Phone
(011) 221 9083/4/5

E-mail
derivatives@absa.co.za

Website
www.absa.co.za

Physical Address

Equity Derivatives
Absa Corporate and Merchant Bank
1st Floor, ABSA Towers North
180 Commissioner Street
Johannesburg
2000