



## Derivative Warrant

Derivative Warrants are very popular investments worldwide, especially in Germany and in Asia such as Hong Kong, Taiwan, Singapore, and Korea. In Thailand, Derivative Warrants SCB-C1 and SCIB-C1 were issued by the Financial Institutions Development Fund (FIDF) and were very popular with investors many years ago. KGI became the first brokerage to issue a Derivative Warrant (PTT13CA) in Thailand, in June 2009.

### Derivative Warrant is also known as:

Derivative Warrant (DW)	Thailand Hong Kong
Covered Warrant	Germany
Structured Warrant	Singapore
Call (Put) Warrant	Taiwan Malaysia
Equity-Linked Warrant	South Korea

### What is a DW?

- Like an option or a traditional warrant, a DW is securities that give the holder the right but not the obligation to buy/sell an underlying asset at an agreed price at specified time.
- The issuer of a DW is a financial company authorized by the SEC to issue DW, not the underlying company of the DW, for example, Securities Company.
- Normally, underlying asset is stock, index, basket, or ETF.
- There are two types of DW which give the right to buy (Call Warrant) and the right to sell (Put Warrant) the underlying asset.
- There are 2 types of settlement, Physical & Cash Settlement.

- There are 3 types of collateral held by issuer which are Fully-Collateralized, Partial-Collateralized, and Non-Collateralized.

### Comparison of Company Warrant and DW (As of June 2009)

Type	Warrant	DW
Asset Type	Securities	Securities
Issuer	Underlying Company	Approved by SEC
Exchange	SET	SET
Underlying Asset	Listed Stock	SET50 Stock
Tenor	Up to 10 Years	2 Months – 2 Years
Type of DW	Right to Buy (Call)	Right to Buy (Call)
Exercise Type	European / Semi American	European
Settlement Type	Physical	Cash
Type of Physical Settlement	New Stock	None
Short Sell	No	No
Market Maker (MM)	No	At least 1 MM
Sector on SET	Warrants	Derivative Warrants
Ceiling / Floor	+/- 30% of Underlying Asset Price	No Ceiling / Floor
Commission	0.25%	0.25%

### Symbol of DW (UUUUICA)

UUUU	Underlying Asset
II	Registered No. of Issued Broker ( KGI = 13)
C	The Right to Buy ( Call )
A	Series A ( A-Z )

### Advantages of Investing in DW

1) **High Gearing:** An investor can invest a much smaller amount in a DW compared with the underlying stock, and may still obtain a similar return when the underlying stock rises in price.

### Example

DW of ABCD Co, Ltd. issued by KGI #Series A (Call Warrant)

Detail as of 1 July 09 (ABCD13CA)

Maturity Date : 30 Dec 09

Last Trading Date : 26 Dec 09

Underlying Asset : ABCD

Exercise Price : 110 Baht

Exercise Ratio : 1 DW per 1 ABCD

Price of ABCD : 100 Baht

Price of ABCD13CA : 5 Baht



On 1 July 09, if an investor has 1,000,000 Baht, investor can

- Option 1** Invest in ABCD, buy 10,000 shares at 100 Baht (10,000 x 100 = 1,000,000 Baht) or
- Option 2** Invest in ABCD13CA, buy 200,000 units at 5 Baht (200,000 x 5 = 1,000,000 Baht)

On 26 Dec 09, if price of both securities are;

Price of ABCD : 120 Baht

Price of ABCD13CA : 10 Baht

The investor can profit on each option as follows;

- Option 1** if investor sells ABCD at 120 Baht, profit will be 200,000 Baht (10,000 x (120-100)) or **20%**
- Option 2** if investor sells ABCD13CA at 10 Baht, profit will be 1,000,000 Baht (200,000 x (10-5)) or **100%**

Basically, with the same amount invested, if the price of the stock goes up, investing in a DW will give a higher return than investing in the stock. However, investor should aware when the price of the underlying stock goes down, investing in the DW will suffer a greater loss than investing in the stock too.

2) **Managing Investment Capital:** Where an investor already owns the underlying shares of the DW, the investor can switch from the underlying shares to the DW, which requires a lower investment. Thus the remaining capital can be invested in other securities for higher return.

#### Example

If an investor has 10,000 shares of ABCD, he can sell all the ABCD shares at 100 Baht and buy 10,000 units of ABCD13CA at 5 Baht. The investor will still gain when ABCD share price goes up and he will also safe keep 950,000 Baht (1,000,000 – 50,000)

3) **Unlimited Gain with Limited Loss:** The maximum loss a DW holder faces is the original purchase price. However, there is no limit to the up side as the DW value will increase in line with the underlying share price.

4) **Market Maker:** For company warrants there is no market maker. However, for each DW, the SET requires at least 1 market maker to provide liquidity, so investors can be assured that they will be able to buy and sell DW at anytime.

#### How to Exercise a DW?

On the exercise date, if the market price of the underlying share is above the exercise price, the DW is “in the money”, the DW will automatically be exercised and the holder will receive cash (Cash Settlement) from the issuer. DW holder does not need to submit any documents as the exercise is automatic.

#### Example

Investor has DW 1,000 units with underlying asset price of 15 Baht, exercise price of 10 Baht, and exercise ratio of 1DW :1stock. On maturity the holder will receive cash payment of 5,000 Baht ((15-10) x 1,000).

Note: Cash payments from the exercise of DW at maturity must be subject to Thai taxation.

#### What are the Risks of Investing in DW?

1) **Credit Risk:** If the DW exercise price is above the market price on the exercise date, the DW holder will receive a cash payment from the DW issuer. Credit risk refers to the risk that the issuer is unable to make the payment on maturity. To minimize this risk, the SEC must approve every DW issuer before any issue. Each DW issuer must also have an investment grade credit rating.

2) **Price Risk:** The price of a DW will vary based on supply and demand and also on the price of the underlying asset. The following factors can also affect the price of a DW.

Factor	Up/Down	Effect on DW Price
Price of Underlying Asset	↑ ↓	↑ ↓
Volatility	↑ ↓	↑ ↓
Time to Maturity	↑ ↓	↑ ↓
Interest Rate	↑ ↓	↑ ↓
Dividend	↑ ↓	↓ ↑

If any of the above factors change they may affect the price of the DW. These factors will also be expected to affect traditional warrants in a similar way.

3) **Limited Tenor:** An investor can buy a DW during its IPO period or buy it on the SET after it begins trading up to the last trading day. However the maturity date of the DW is fixed, and set at the time of the IPO, at between 2 months and 2 years. After the maturity date the DW will have no value and cannot be traded on the SET.

#### How will the issuer benefit from issuing the DW?

The issuer can use the DW to manage its risk. The issuer will partially buy the underlying asset to reduce its risk. If the price of the underlying asset increases, the value of the underlying asset held by issuer will also increase. On the other hand, if the price of the underlying asset decreases, the issuer may sell the underlying asset. When a DW is traded on the SET the brokers involved will charge a commission – the commission is fixed at 0.25% regardless of whether the broker is the DW issuer or not.

#### How to Invest in DW?

Investors can buy and sell DW just the same as other shares and warrants listed on the SET. There are two ways to buy a DW:

- 1) In the IPO
- 2) On the SET after trading starts

Investor who has any questions related to DW, please feel free to contact KGI Equity Derivative Department.



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