Warrants

Definition

- A warrant is a geared financial instrument which gives the warrant holder the right but not the obligation to buy, sell or participate in the performance of the underlying security, before or on the expiry date
- Differences between Warrants and Options

Warrants	Options
Traded on the **Equity Market**	Traded on **the Derivatives Market**
Listed by **Issuers** on the JSE	Listed by the **JSE**
Volatility levels allocated by the **Issuer**	Volatility Levels allocated by **JSE**

Structure and Features

- **Leverage/Gearing**

  To use a financial instrument to gain greater exposure to the potential return on an investment while investing a smaller amount

- **Underlying Security**

  What the warrant is written on. Can be a variety of securities ranging from shares to currencies and commodities

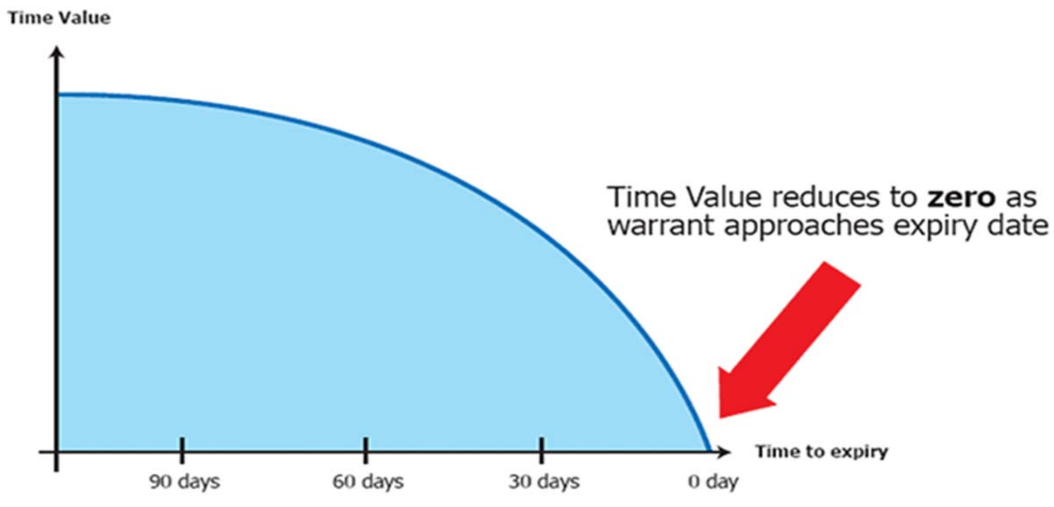
- **Cover Ratio**

  The number of warrants one has to purchase to gain exposure to one security

Structure and Features

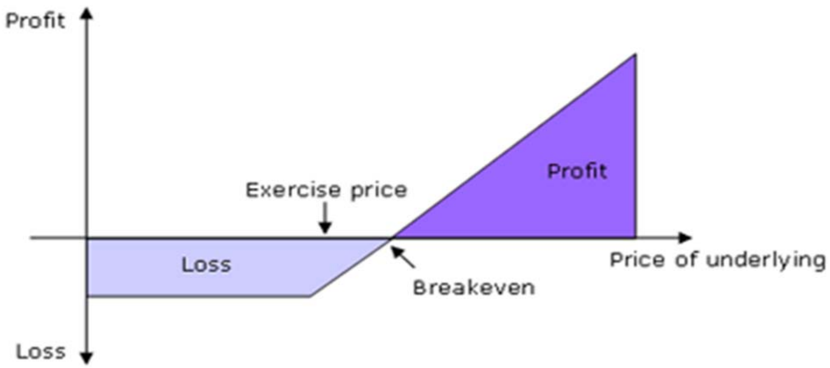
- **Strike Price (also known as the Exercise Price)**
  - The price, initially agreed upon, at which the investor can buy or sell the underlying security

- **Expiry Date**
  - The last date on which the warrant holder can exercise their rights



Call Warrants

- Can be classified into **2 categories (Call Warrant and Put Warrant)**:
  - **Call warrants -** gives the holder the option to **purchase** an underlying security at an agreed price

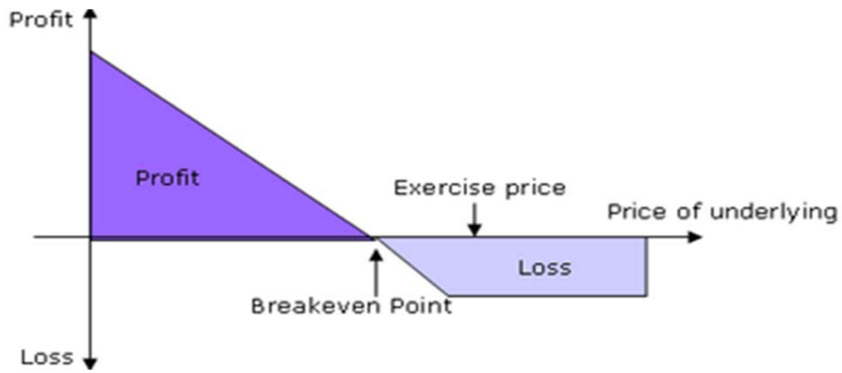


  - **For example:**

    If an investor believes that the price of Share A will increase they will buy a call warrant that **allows them to purchase** Share A at the strike price R100. If in future the price rises to R120 the warrants holder can exercise the right to purchase Share A at R100

Put Warrants

- **Put warrant -** gives the holder the option to **sell** an underlying security at an agreed price.



- **For example:**

If an investor believes that the price of Share A will decrease they will buy a put warrant that **allows them to sell** Share B at the strike price R90. If in future the price drops to R80 the warrants holder can exercise the right to sell Share B at R90

Warrant Styles

- Traded just as any other security on the JSE
- Can be 1 of 2 styles
  - **American**

The warrant holder may exercise their rights at any time between listing and the expiry date

  - **European**

The warrant holder may only exercise their rights at the expiry date

Benefits

- **Advantageous in bull and bear markets**

  Whether you believe the market is going to rise or fall there is a warrant for you

- **Reduced Cost**

  The cost of trading in the warrant is generally a lot cheaper than the cost of trading directly in the underlying

- **There is unlimited upside, but limited downside**

  The maximum loss one can make on a warrant investment is the initial price/premium

- **Leverage**

  Investors can gain full exposure to the price movement of the underlying securities by investing a smaller amount of capital

- **The presence of a market maker ensures liquidity**

  The issuer of the warrant will always buy back warrants should an investor want to end his particular exposure

Factors to consider

- **Market Risk**

  The value of a warrant is influenced by the value of the underlying.
- **Limited life of warrants**

  Warrants have a limited life span and thus the warrant may expire without the holder's expectations being realised
- **Limitation of rights**

  Holding a warrant does not give the investor the same rights as holding the underlying share until the warrants are exercised. An example of a right is - voting at annual general meetings
- **Extraordinary event**

  In certain circumstances the warrant issuer has the right, to declare an extraordinary event, resulting in expiry of the warrant, prior to the specified expiry date
- **Credit risk**

  Purchasing a warrant from a particular issuer implies that you are taking on the credit risk of that issuer

Types of Warrants

- **Single Equity Warrants (Vanilla Warrants)**
  Warrants are issued on a single security. They are currently the most popular type of warrant traded. Settlement is in cash terms or by delivery of the underlying security

- **Index Warrants**
  These warrants are issued on a particular index and are settled by way of a cash payment

- **Basket Warrants**
  These are similar to single equity warrants except the underlying security is a basket of securities rather than a single security. The basket generally includes companies within particular industry

- **Barrier Warrants**
  These are single equity warrants that have a barrier level into which the price of the underlying is confined. If this level is breached by the underlying security the warrant lapses and becomes worthless

How to invest in warrants?

- To buy or sell warrants on the Johannesburg Stock Exchange (JSE) you need to open a brokerage account with an accredited stockbroker;
- You can find a list of the JSE accredited stockbrokers here.

Contact us

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