

What is Equity Linked Note

Equity Linked Note (ELN) is a yield enhancement instrument which relates to equities & provides investors with the opportunity to attain superior yield over money market instruments. The most common “bull” ELN is particularly suitable for investors who believe that the underlying stock will not have too much upside or downside.

Since the other types of ELN like “Bear” and “Strangle” are less popular, **the rest of this presentation is focused on “Bull” ELN.**

Features of ELN

ELN has two primary components:

- Short Term Deposit

For “Bull” ELN: investors sell a put option, which can enhance the yield of the deposit if underlying equity price closes at or above the strike price on the valuation date.

For “Bear” ELN: investors sell a call option, which can enhance the yield of the deposit if underlying equity price closes at or below the strike price on the valuation date.

For “Strangle” ELN: investors sell both a call and put option at different strike prices, which can enhance the yield of the deposit if underlying equity price closes at or above the lower strike but at or below the upper strike prices.

Example of ELN

Type	:	Bull
Underlying Stock	:	Henderson Land (0012.HK)
Issue Price	:	98.22%
Strike Price	:	60.45
Reference Spot	:	64.50
Settlement Date	:	29 April 2008
Valuation Date	:	17 June 2008
Maturity Date	:	19 June 2008
Yield	:	13.70% (annualized)

If an investor wants to buy a notional amount of HKD100,000 of this ELN, he has to

pay HKD98,220 (par value x issue price) on 29 April 2008 (settlement date).

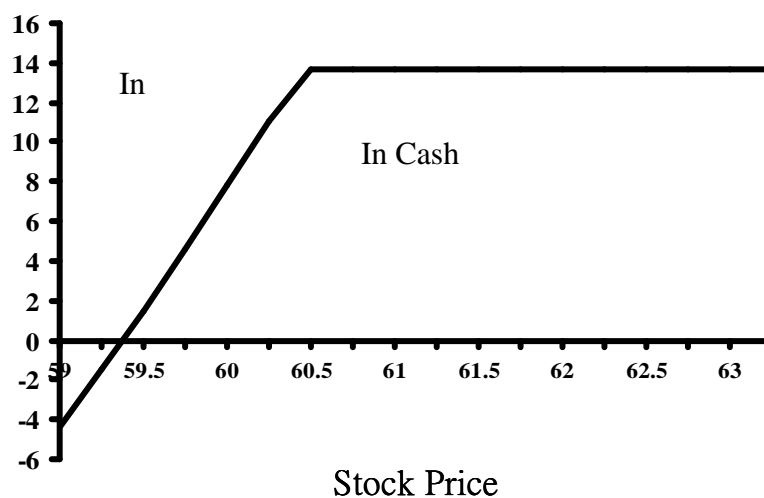
If the share price of Henderson Land closes at or above 60.45 (strike) on 17 June 2008 (valuation date), he will get HKD100,000 on 19 June 2008 (maturity date) with an annualized return of 13.70% (yield).

If the share price of Henderson Land closes below 60.45 (strike) on 17 June 2008 (valuation date), he will get 1,654.26 shares of Henderson Land (par value / strike price) on 19 June 2008 (maturity date).

Payoff of ELN

<u>Stock Price on Valuation Date</u>	<u>Payoff at Maturity</u>	<u>51 Days Return</u>	<u>Annual Compound Return</u>
59.00	In Shares	-0.6%	-4.4%
59.25	In Shares	-0.2%	-1.5%
59.50	In Shares	0.2%	1.5%
59.75	In Shares	0.6%	4.6%
60.00	In Shares	1.1%	7.8%
60.25	In Shares	1.5%	11.1%
60.50	In Cash	1.8%	13.7%
60.75	In Cash	1.8%	13.7%
61.00	In Cash	1.8%	13.7%

Payoff of ELN



Break Even Point of ELN

Break Even Point of ELN is the share price at which the investors have no profit or loss in buying the ELN.

Break Even Point = Strike Price x ELN Price

In the previous example, the Break Even Point = HKD60.45 x 98.22% =HKD59.37

Benefits of ELN

- Attain superior yield over money market instrument if stock closes at or above the strike on valuation date
- Buy stock at a lower than current price if stock closes below the strike on valuation date
- Some issuers of ELN may provide secondary market in the ELN
- Flexible in the choice of underlying equity and maturity

Disadvantages of ELN

- Denominations of trades larger than equity investment
- Do not allow frequent asset reallocation
- ELN underperforms the underlying equity before maturity when the underlying moves favorably
- Maximum loss incurred when underlying drops to zero after the ELN being exercised
- Exposure to the issuer's credit risk

Some Terms

- Launch Date

The date on which the level of the underlying equity is fixed

- Settlement Date

The date the investors is required to pay for the ELN

- Determination/Valuation Date

The date the closing level of underlying equity is fixed

- Maturity Date

The date the redemption amount is payable to the investors, or the shares of the underlying stock are delivered to the investors

- Issue Price

The price of the ELN, denominated in percentage of the par value, to be paid by the investors

- Strike Price

The level of the stock price which determines if the investors receive cash or stocks on the maturity date

- Par Value

The amount to be received by the investors on the maturity date if the share price of the underlying stock closes at or above the strike price on the valuation date

- Yield

The annualized return to be received by the investors if the share price of the underlying stock closes at or above the strike price on the valuation date

Who are Eligible ELN Buyers

- Sophisticated investors
- Investors who would like to buy a particular stock but at a price slightly lower than the current price
- Investors should be prepared that they may have to take up the stock position if the price falls below the strike on valuation date

Misunderstandings about ELN

- **Will ELN increase market volatility?**

There is the perception that if the underlying share price has dropped to near the strike price, this might trigger lots of cut-loss orders and further aggravate the selling pressure. The fact is, at the time of selling the ELN to investors, the issuer will perform dynamic hedging to reduce the risk involved until when the ELN matures. Hedging involves buying a certain number of shares as an ELN transaction is executed. As share price goes up and the chance of exercising the ELN is getting less, the issuer will sell the shares; but as the share price drops and the chance of exercising the ELN is increasing, the issuer will buy more shares. As a result, the share price will become stable and market volatility will be reduced.

- **Is ELN only for rich investors?**

As ELN is becoming increasingly popular, banks and brokers now may offer their clients a minimum investment size of HKD100,000. ELN is therefore not only for the “Rich Man”.

- **Does ELN provide opportunity of shares liquidation for the large securities firm?**

According to the previously mentioned hedging method, the issuer has to buy

more shares as the price drops further. Issuing ELN is therefore not a way for the large securities firm to sell their shares.

- **Does ELN provide stop-loss function?**

Issuers may provide secondary market for the ELN investors to sell their ELN positions.

- **Does ELN have unlimited risk?**

No, because buying the most common “Bull” ELN is like selling a put option. The *maximum* loss an ELN investor may suffer is when the stock price drops to zero. The risk involved is actually the same as buying a common stock, and the loss is not unlimited.

- **Will ELN trigger stop-loss orders & short-selling activities?**

Stop-loss & short-selling are normal market activities, and these activities are not directly related to ELN. Some investors however perceive these activities as a result of falling stock prices to near the ELN strike prices. In practice, a rational investor will set his own stop-loss limit. There are many factors behind market weakness and bearish market sentiment, but these are not primarily due to ELN being in the market.