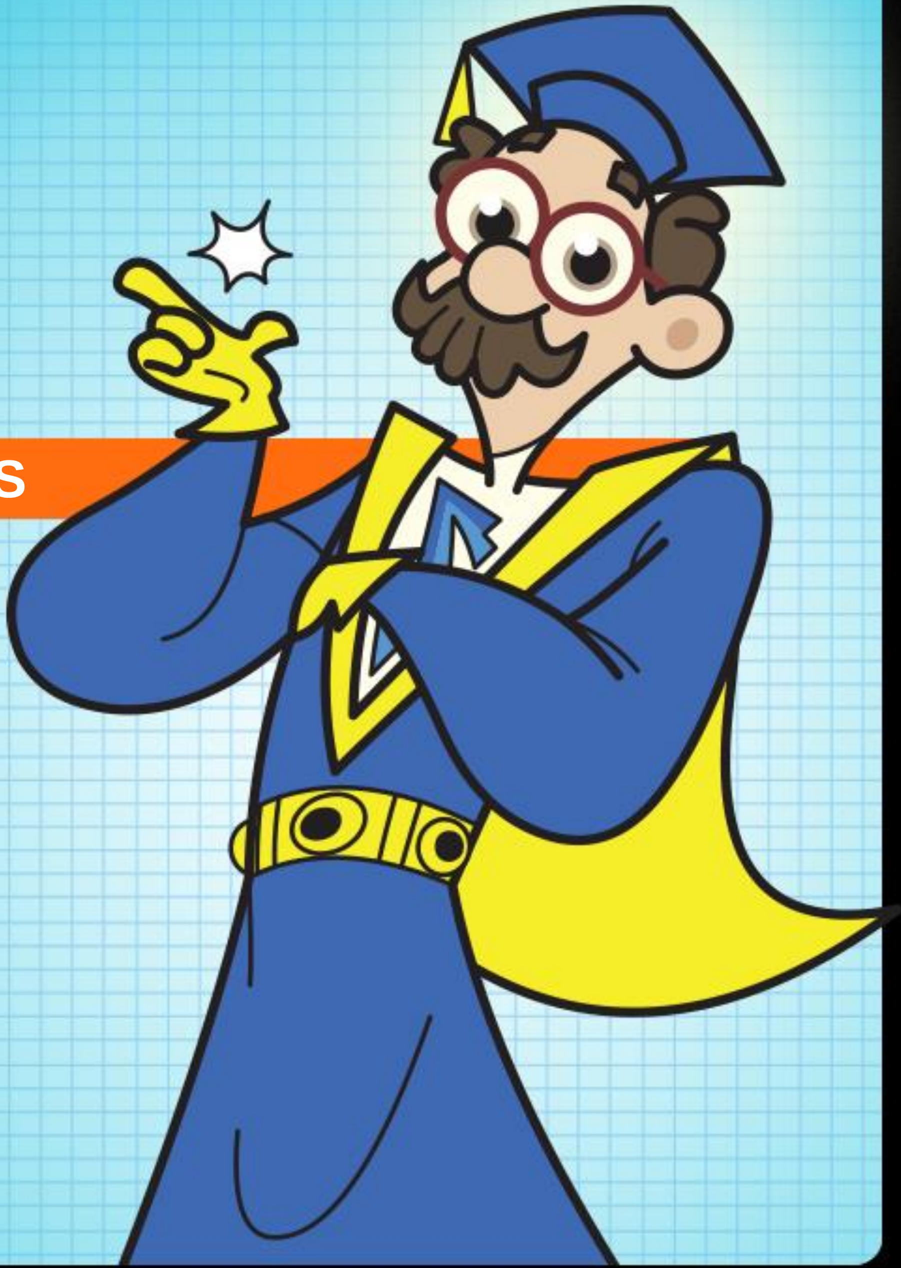
EQUITY LINKED DEBENTURES



Equity Linked Debentures

– By Prof. *Simply* Simple

EQUITY LINKED DEBENTURES

- With high volatility in the equity markets, investors are increasingly looking at financial products which provide stability along with decent returns.
- ‘Equity-Linked Debentures’ (or ELDs) are products that provide:
  1. Capital protection,
  2. A slice of the stock market based returns

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What are ELD's?

- An ELD is a form of a fixed income product.
- It differs from a standard fixed-income product as the final payout is based on the return of the underlying equity.
- It is structured so as to give 100% capital protection with a provision for equity participation.
- Bonds are rated by an accredited rating agency.

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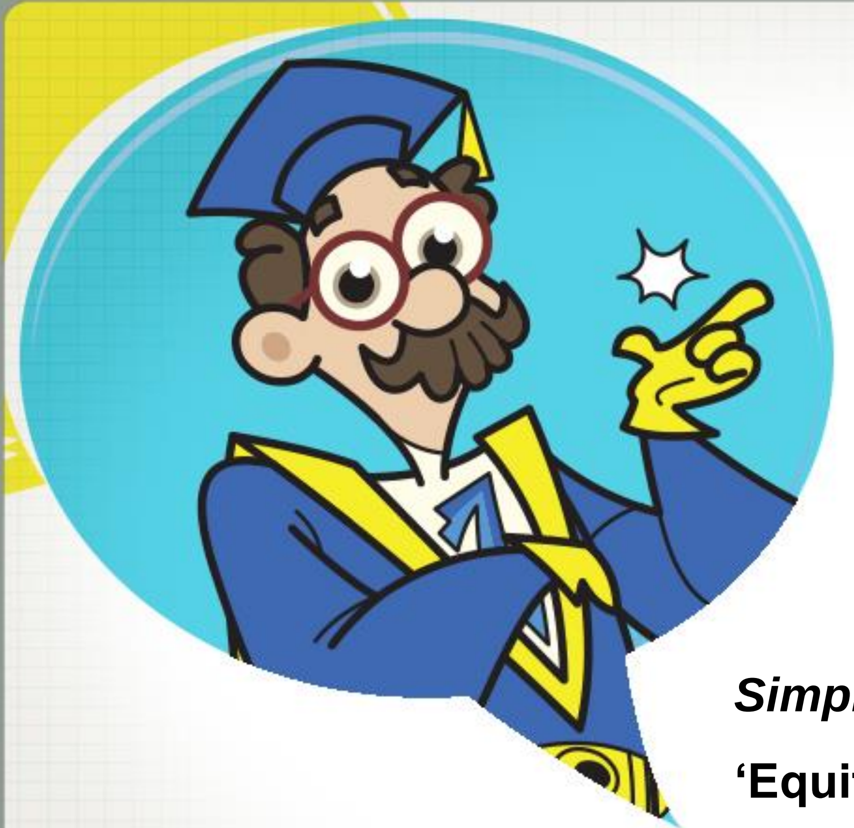

Simply **put…**

‘Equity Linked Debentures’ are popularly known as capital protection funds & give you the upside of equities and protect the downside!

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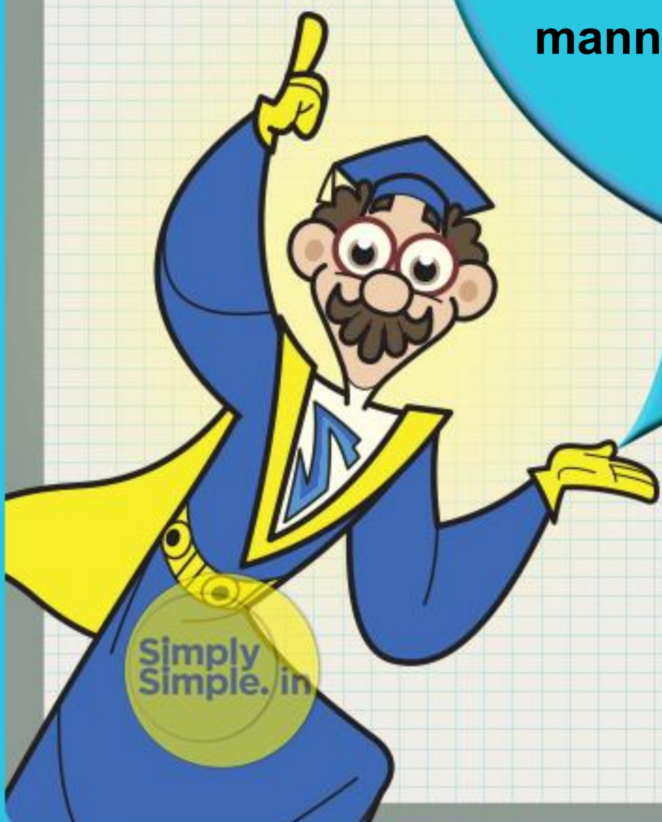
The actual terms of these products may vary slightly, but the broad theme of ELD works in this manner…



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- These bonds are linked to an index.
- The issuer of bonds invests a pre-determined part of the principal amount collected in fixed income securities, which provide principal protection.
- The balance is invested in call options which provide the exposure to equity.

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For example…

- **The returns are calculated in this manner:**
- **Say, the fund house comes to an initial value of the Nifty, which is often the average of the first three months.**
- **Also suppose, the Nifty's value has been 3,800, 4,000 and 4,200 at the end of months 1, 2 & 3:**
- **The average works out to 3800+ 4000 + 4200/3 = 4000**

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Therefore…

- **The final value is also calculated as the average of the last three months.**
- **Now, if the Nifty's value closes at 5,000, 5,200, 5,500 in months 34, 35 and 36 respectively, we can calculate the average to 5,233.**
- **So, the final Nifty returns come out to 5,233 -4,000/4,000*100 = 30.82 per cent over the three-year period.**
- **The Nifty return, multiplied by the participation ratio (that is pre-decided by the fund) is the final return.**

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Here's a new term for you to know…

- **Participation Ratio is the ratio at which ELD participates in the appreciation of the underlying equity index (say the Nifty).**

- **E.g. Participation Ratio of 100% implies that a 10% increase in the Nifty will result in a final equity-linked coupon of 10%.**

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To finally illustrate…

Principal Remains Intact + **Equity Market Participation** = **Equity Linked Debentures (ELD)**

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But remember…

- **Equity linked debenture schemes do not allow premature exits.**
- **All benefits are subject to investment being held till redemption date.**
- **These products, though listed on the exchanges, are a bit illiquid and hence difficult to sell or transfer.**
- **In certain cases, the issuer or arranger of the notes may offer to buy back the notes at a certain cut-off.**

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To Sum Up

- If investors model and balance their portfolio in a disciplined manner and then hold it long term, they will derive the same benefits as that of an equity linked plan.

- By investing in these schemes, on the upside,
  they may get a return related to the appreciation of the Nifty.

- At worse, they won't lose their capital.

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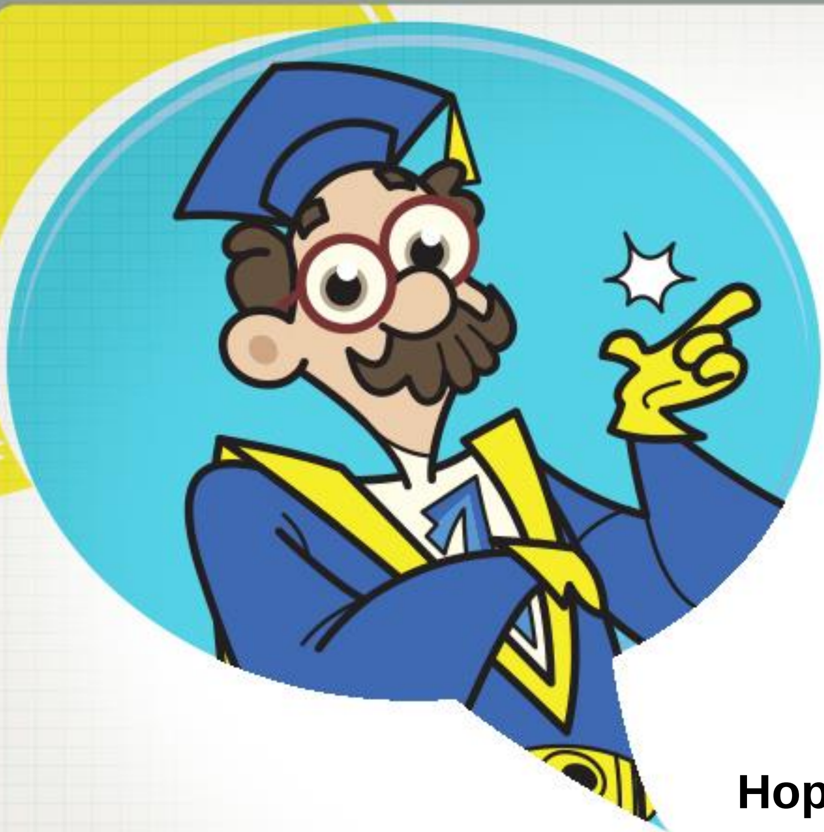

Hope you have now understood

the concept of

Equity Linked Debentures

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Thinking of Investment

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