ARGENTUM Asset Management Inc.

CASE STUDY 2: MANAGING A CONCENTRATED STOCK POSITION USING OPTIONS

Managing a concentrated public stock position

High Net Worth Investors (HNWI) often hold large portfolio positions in a single stock, often with a low cost basis. What is usually common about HNWI's is that they are typically entrepreneurs who successfully managed companies and then sold them to a publicly traded company in exchange for a combination of cash and stock and in the acquiring company.

The investor may not want to sell the stocks at current levels as they are still bullish on the stock but may want to enjoy some liquidity until the stocks reach their target exit price. A covered call writing strategy can achieve this objective.

This strategy involves writing covered calls*. A "covered call" is an income-producing strategy where we sell, or "write", call options against shares already owned. In exchange for selling the call options, we collect an option premium. But that premium comes with an obligation. If the call option sold is exercised by the buyer, we will be obligated to deliver the shares of the underlying stock. Fortunately, the underlying stock is held in the portfolio, so the potential obligation is "covered" – hence this strategy's name, "covered call" writing.

Selling calls allows for an extra income stream as well as achieving the target exit price. This is possible because, covered call writers (us) can select an exit price (strike price) for the stock and the total return would be strike price (exit price) plus premium received if the stock trades above the strike at expiration.

Should the options expire worthless (for the buyer) ie. the underlying stock price trades below the strike price at expiration, we would keep the entire option premium at expiration and continue to retain the shares of the underlying stock.

***A call option is an option contract in which the holder (buyer) has the right (but not the obligation) to buy a specified quantity of a security at a specified price (strike price) within a fixed period of time (until its expiration).**