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Unlocking Value

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Equity Risk Management Strategies for High Net Worth Investors

This presentation should be preceded by or accompanied with "Characteristics and Risks of Standardized Options" from the Options Clearing Corporation.

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Introduction

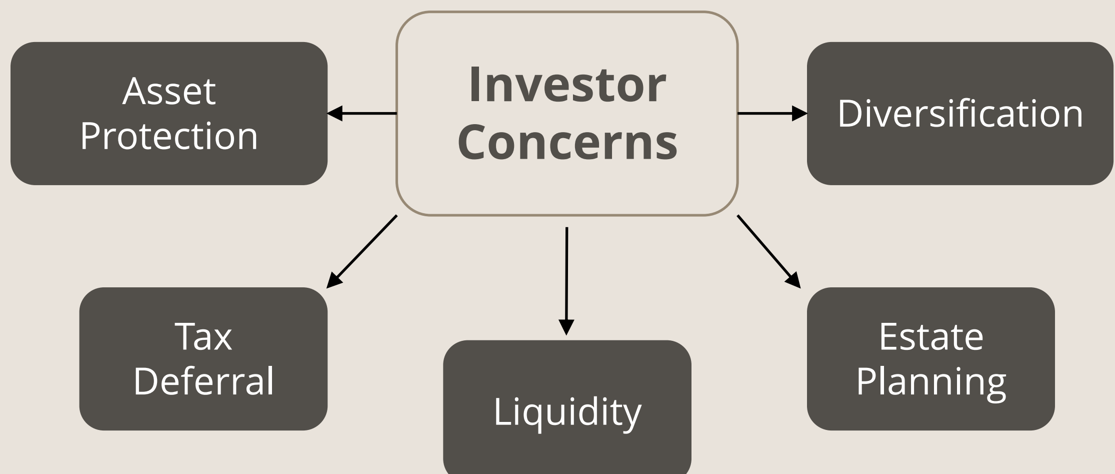
Moors & Cabot can assist investors who find a significant portion of their net worth concentrated in equity positions.

Moors & Cabot's Single Stock Risk Management (M&C) specializes in equity risk management strategies. These strategies utilize derivative options, which are private contractual arrangements between the investor and an institutional counterparty. The options used in these strategies are privately negotiated and are not publicly traded options or futures. M&C acts as an agent for investors by soliciting privately negotiated pricing bids from several top-rated institutional counterparties. M&C utilizes its relationships with these counterparties to solicit competitive pricing.

Many investors find that they have a concentrated equity position for a variety of reasons:

- Sale of business in a stock-for-stock merger
- Stock price appreciation during extended bull market in U.S. equities
- Significant appreciation of employer-issued stock and stock options
- Inheritance or gift

The owners of these positions often have a low tax basis. In addition, the sale of these securities may be prohibited or restricted for regulatory reasons.



Purchasing a Put Option (Continued)

How does this strategy work?

A put option provides downside price protection.

- Many investors who hold a concentrated equity position may be concerned about a possible decline in the value of that stock position. These investors may protect their position by purchasing a put option on that stock. The put option effectively establishes a "floor" price (called the "put strike price"), and protects investors from stock price declines below that price when the put option is exercised. The transaction can be structured so that the investor may elect at expiration to settle the put option in cash or may deliver the underlying shares at maturity if the stock price is below the put strike price. If the stock price is above the put strike price at expiration, the put option may expire without value and the investor will then lose the premium.

An investor's risk includes the complete loss of premium paid.

Example:

- An investor who owns 50,000 shares of a stock trading at $100 per share is interested in protecting his position. By paying a premium and purchasing a put option with a strike price of $90, the investor is protected from a price decline below $90.

- Assuming the stock is trading above $90 at maturity, the put expires worthless.

- Assuming the stock is trading below $90 (at $50, for example) at maturity, the investor may sell (or "put") the stock to the counterparty at a price of $90 per share. Alternatively, the transaction can be structured so that the investor may defer tax liability on the sale of the underlying stock by electing to receive $40 per share in cash ($90 — $50) for settlement of the put option and thereby retain ownership of the shares. Please discuss any taxation of the put transaction with your tax advisor.

Purchasing a Put Option (Continued)

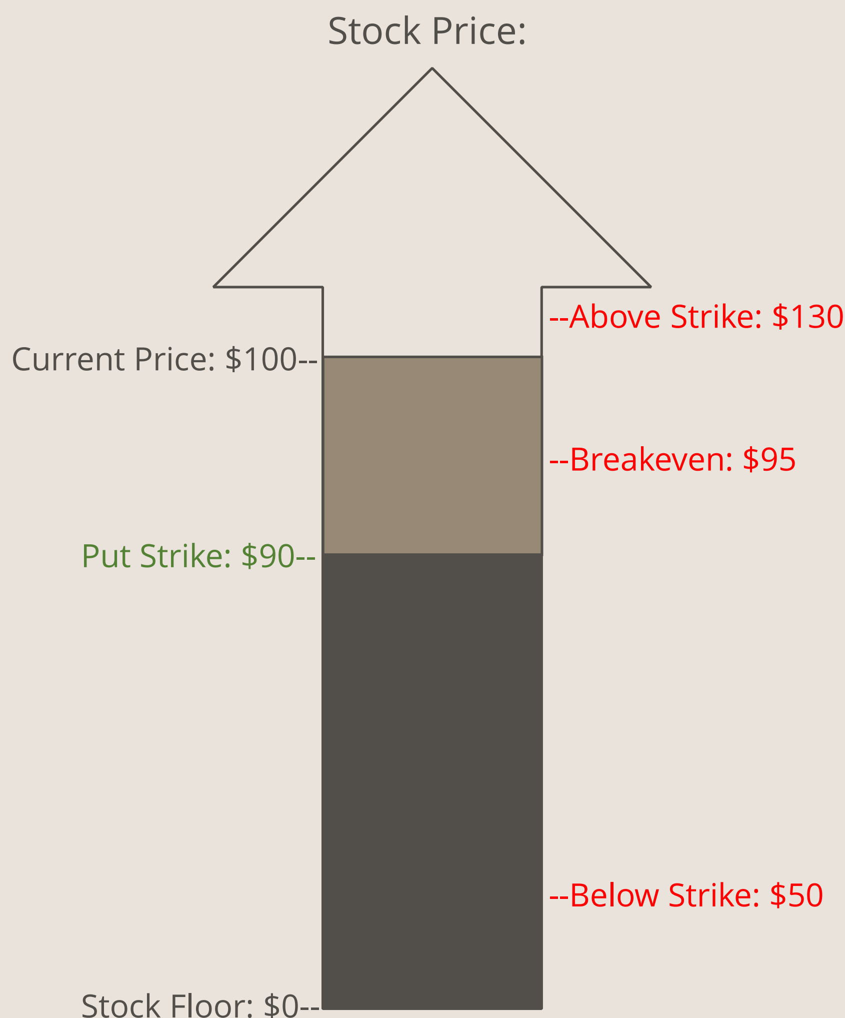
How does this strategy work?

At Maturity (three example scenarios):

Final Stock Price	Put Strike	Exercise Put?	Put Benefit	Put Premium	Net Value*
$130	$90	No	$0	$5	$125
$95	$90	No	$0	$5	$90
$50	$90	Yes	$40	$5	$85

*Net value of transaction equal to final stock price minus premium plus put benefit.

The example below is for illustrative purposes only. Each individual stock will have different pricing parameters depending upon market conditions, commissions, fees and other factors specific to each transaction. If fees or commissions were included for the example below, the outcomes would be less favorable.



Selling a Covered Call Option

How does this strategy work?

The sale of a covered call option provides income and may allow participation in stock price gains up to a certain level.

- An investor interested in enhancing the yield of a portfolio may sell a covered call option on an underlying stock. The investor will receive a premium for the call option whose value is determined based on several factors, including the volatility of the stock, the proximity of the strike price to the current stock price, length of time until maturity, and other market conditions. The investor will participate in all price gains up to the call strike price. The transaction can be structured so that the investor may elect at expiration to settle the call option in cash or may deliver the underlying shares at maturity if the stock price is above the call strike price.

Example:

An investor's risk includes the complete forfeiture of any gains above the call strike price and may require a physical delivery of the stock.

- An investor owns 50,000 shares of a stock trading at $100. The investor wants to enhance portfolio yield, but feels that the stock has limited upside potential in the near term. The investor may sell a call option on the underlying stock with a strike price of $120 per share and receive payment today, called a "premium."
- Assuming the stock is trading at $125 at maturity, the counterparty may buy (or "call") the stock from the investor at a price of $120 per share. Alternatively, the transaction can be structured so that the investor may defer tax liability on the sale of the underlying stock by electing to pay the counterparty $5 per share in cash ($125 — $120) for settlement of the call option and thereby retain ownership of the stock. Please discuss any taxation of the call transaction with your tax advisor.
- Assuming the stock is trading below $120 at maturity, the call option expires worthless.

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Selling a Covered Call Option (Continued)

How does this strategy work?

At Maturity (three example scenarios):

Final Stock Price	Call Strike	Call Exercised?	Cash Charge*	Call Premium	Net Value**
$125	$120	Yes	$5	$10	$130
$110	$120	No	$0	$10	$120
$90	$120	No	$0	$10	$100

*Cash charge equals cost to settle charge.
**Net value of transaction equal to final stock price plus call premium minus cash charge.

The example below is for illustrative purposes only. Each individual stock will have different pricing parameters depending upon market conditions, commissions, fees and other factors specific to each transaction. If fees or commissions were included for the example below, the outcomes would be less favorable.

Zero-Premium Collar

How does this strategy work?

A zero-premium collar may be structured such that the investor gains downside price protection without paying an up-front premium.

- A Zero-Premium Collar is a risk management strategy whereby an investor sells an out-of-the-money covered call option and uses the premium received to purchase an out-of-the-money put option, providing the investor downside price protection. The maturity of a collar can range from several months to several years, and both options may mature simultaneously. By negotiating the call strike price, the investor's out-of-pocket cost can be reduced to "zero." The Zero-Premium Collar may be appropriate for investors who are legally restricted or have practical limitations on selling their stock (e.g. restricted or unregistered stock, or stock with a low cost basis).

Example:

An investor's risk includes the complete loss of premium paid for the put, the complete forfeiture of any gains above the call strike price, and the possible requirement to physically deliver the stock.

- An investor owns 50,000 shares of a stock that is trading at $100. The investor wishes to protect his position, but is reluctant to sell because of a low cost basis, or is unable to sell due to legal restrictions. The investor is willing to limit potential upside on the stock beyond a certain price in order to eliminate any "out-of-pocket" cost for downside price protection.

- With the proceeds from the sale of a call option at approximately 120% of the current stock price, the investor is often able to purchase a put option at 90% of the current stock price. For no out-of-pocket cost, the investor now has downside protection below $90 per share, and is still able to participate in price gains up to $20.

Zero-Premium Collar (Continued)

How does this strategy work?

At Maturity (three example scenarios):

Final Stock Price	Put Strike	Call Strike	Exercise Put?	Call Exercised?	Put Benefit	Cash Charge*	Net Value**
$125	$90	$120	No	Yes	$0	$5	$120
$115	$90	$120	No	No	$0	$0	$115
$75	$90	$120	Yes	No	$15	$0	$90

*Cash charge equals cost to settle call.
**Net value of transaction is equal to final stock price plus benefit minus cash charge.
^Breakeven is between $90-$120 as there is no cost /benefit to the strategy between these values.

The example below is for illustrative purposes only. Each individual stock will have different pricing parameters depending upon market conditions, commissions, fees and other factors specific to each transaction. If fees or commissions were included for the example below, the outcomes would be less favorable. Zero-Premium Collars will entail substantial commissions as they require multiple contracts compared with a single options transaction.

Variable Pre-Paid Forward Sale

How does this strategy work?

A variable prepaid forward sale may provide a greater level of monetization than alternative hedging strategies.

- A Variable Pre-Paid Forward Sale is a risk management strategy suitable for investors whose primary goal is to monetize a concentrated equity position without incurring an immediate tax liability. The variable pre-paid forward sale may be appropriate for investors who are legally restricted or have practical limitations on selling their stock (e.g. restricted or unregistered stock, or stock with a low cost basis).
- Investors may receive a one time up-front payment generally ranging from 75% to 95% of the value of their stock and have no obligations to the counterparty until the expiration of the transaction. The amount of the up-front payment may be affected by several factors, including the term of the transaction, the level of an investor's upside potential, prevailing interest rates, and other market conditions.

An investor's risk includes the complete loss of any costs associated with the structure, the complete forfeiture of any gains above the upper strike price, and the possible requirement to physically deliver the stock.

Example:

- An investor owns 50,000 shares of a stock trading at $100 per share, a $5,000,000 position. The investor wishes to create liquidity, but is reluctant to sell because of a low cost basis, or is unable to sell due to legal restrictions.
- In structuring the variable pre-paid forward sale, this example has a lower strike at 100% of the current stock price, and an upper strike at 125% of the current price. Assuming an up-front payment of 85%, the investor would receive $4,250,000, which may be reinvested to provide diversification.
- At maturity, the investor may typically elect to settle the transaction either by delivering stock or cash. The amount to be delivered will be determined by several factors, including the market price of the stock at maturity. The investor never receives more than the up-front payment, but may retain a portion of his/her shares (or if they so choose, the cash value of such portion), if the stock value has increased.

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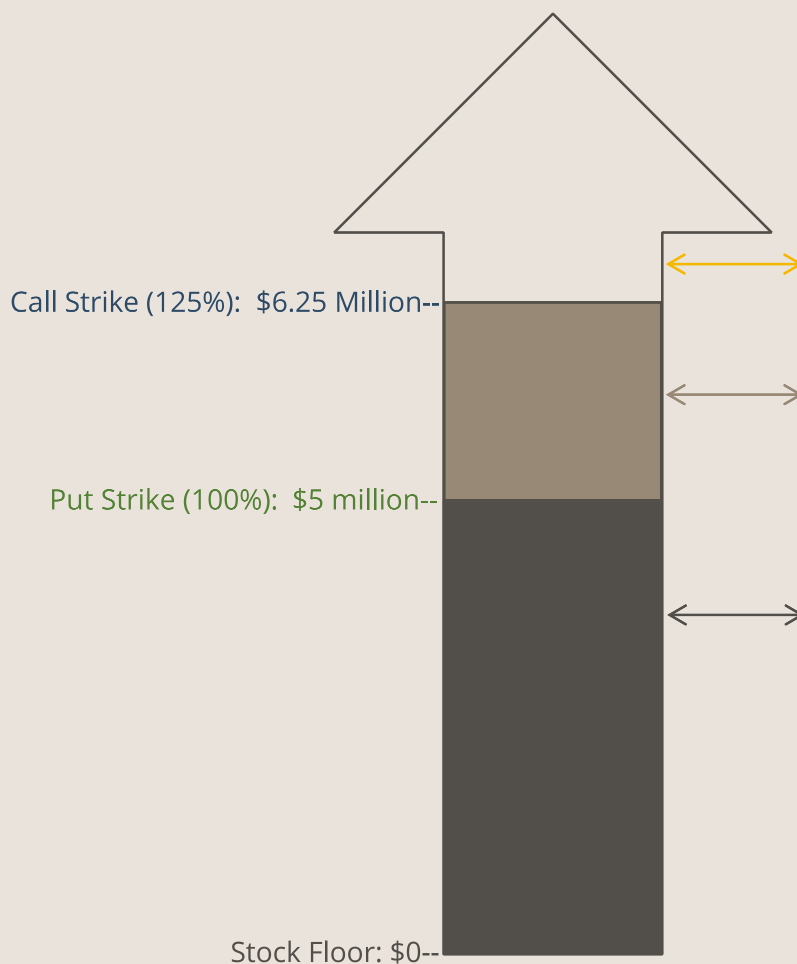
Variable Pre-Paid Forward Sale (Continued)

How does this strategy work?

The example below is for illustrative purposes only. Each individual stock will have different pricing parameters depending upon market conditions, commissions, fees and other factors specific to each transaction. If fees or commissions were included for the example below, the outcomes would be less favorable. Variable Pre-Paid Forward Sales will entail substantial commissions as they require multiple contracts compared with a single options transaction.

Stock Value at Maturity



At Maturity (three example scenarios):

This does not include any benefit from reinvesting the $4,250,000 up-front payment.

Investor keeps $1.25 million worth of shares, delivers the balance of the shares.

Investor delivers $5 million worth of shares, retains the balance of shares.

Investor delivers 100% of shares.

Investor may also have the choice to deliver cash in lieu of shares at maturity.

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Contract Specifications:

- These transactions are binding, contractual agreements with a specified maturity. However, in practice, counterparties are typically willing to terminate early or renegotiate the original contract and terms. The counterparty is not required to change any terms of the contract; their willingness to do so is determined on a case-by-case basis, and may be subject to additional costs and expenses.

- The examples shown above are for illustrative purposes only and may not indicate future performance as options pricing can be affected by, but is not limited to, time, market, interest rate, and volatility fluctuations. Each pricing structure is calculated assuming certain parameters, which are subject to change. Investors should carefully consider executing any trade using options and be aware of all the risks, including, but not limited to, receiving back less value than they invested.

- These transactions can generally be settled in cash or in stock. Investors should specify in their original contract which delivery alternative they prefer. These transactions can be customized for any number of shares and any specific maturity date.

- Institutional counterparties generally require investors to have a minimum net worth of $2-$5 million for these transactions.

- Hedging transactions are neither FDIC guaranteed nor insured by any government agency. The “stock protection” referenced in this presentation refers to the put option purchased by the client. Clients are general creditors of the Counterparty which executes their transaction.

Important Considerations:

- Options are not suitable for all investors.
- A copy of a current options disclosure document, "Characteristics and Risks of Standardized Options" has been provided. This document discusses potential risks with options issued by the Options Clearing Corporation ("OCC"), which are typically listed on an exchange. It may not discuss the additional risks of privately negotiated option contracts, and investors should be aware of potential risks with their counterparty, including credit risk, possible restrictions on stock transfer, and foreign jurisdictional tax requirements.
- Taxes, fees, and commissions do have a direct and material impact on the options strategies, may reduce the effectiveness of some strategies, and may result in the investor not achieving his or her investment objectives. Please note that additional taxes, fees, and commissions may have a direct and material impact on the renegotiation of any options strategy.
- The examples presented above do not take into account the tax consequences or the impact on holding period. Investors should always seek professional tax advice before engaging in any of these strategies. Moors & Cabot, Inc. does not provide tax legal or accounting advice and the information contained herein should not be construed as such.
- The example shown above has been calculated for illustrative purposes only. Clients should rely on details provided in their final trade documents before execution.
- Supporting documentation for any claims, comparison, recommendations, statistics, or other technical data, will be supplied upon request.
- Options are not suitable for all investors and there are significant risks inherent in the use of options, even when options are used for hedging purposes. The information contained herein has been prepared from sources believed to be reliable, but is not guaranteed by us and is not a complete summary or statement of all available data.

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