"StockOpter® *Insight* – It's Not An Analysis Tool; It's a *Relationship* Tool!"
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Planning for Employee Stock Options (ESOs) is one of the hardest elements of financial planning. The rules are complex, and the strategies for employing those rules to achieve clients' goals require considerable expertise. Fortunately, for those of us with limited understanding of ESOs, but who want to offer help to our clients in this vital area, there's **Net Worth Strategies, Inc.** (NWSI).

Net Worth Strategies, Inc. offers consulting and education in ESO planning, as well as software for advisors. Their "StockOpter®" is an incredibly strong analysis and planning tool, but requires considerable ESO expertise and experience to use properly. Recently, they released a new software program, "StockOpter® *Insight*" - and it's a whole new ball game.

StockOpter® *Insight* wasn't designed to perform elaborate ***analysis*** of a client's employee stock options or to model ***strategies*** for exercising them; its big brother does both superbly. It was built to give the advisor – who may not have extensive expertise or experience in ESO planning – an easy to use tool to help ESO-holding clients to a better ***basic understanding*** of their options holdings and of the ***risks*** inherent in them. This, by itself, would be a worthy goal, but StockOpter® *Insight* goes further. It gives advisors the ability to ***monitor*** the clients' option portfolios over time, to help them ***manage*** those risks. In short, it's a ***relationship tool.***

It works like this:

1. The advisor contacts the prospective (or existing) client and offers to prepare a ***Personal Option Profile Report*** that (quoting from the supplied "Prospect Letter") "looks at your stock options from three perspectives:

   1. **Portfolio Value**: The current *in-the-money*, *cash-out* and *time* values of your vested and unvested options
   2. **Investment Risk/Reward**: The value and leverage of your options as the price of your company stock increases or decreases
   3. **Personal Risk/Reward**: An evaluation of your option holdings with regard to achieving your financial goals and the risk inherent in your current position.

Your *Personal Option Profile* will help you to clarify your stock option goals and enable you to establish the criteria by which we can monitor your option position in order to take timely action. To prepare your *Personal Option Profile* I will need you to supply the following information:

- Your current grant summary report (contact your option plan administrator)
- Your *Financial Freedom Goal*
- The current value of your diversified portfolio

- The number of directly held company shares and their cost basis
- The number of restricted shares and the price you paid for them"

That's ***not*** a lot of required information, and it won't take the prospect a lot of time to assemble. More importantly, the three Perspectives promised are clearly worth acquiring.

2. The advisor delivers the ***Personal Option Profile Report*** to the client and reviews it with her. This report is ***really something!*** Not only does it detail the ***present value*** of the client's options (current *in-the-money*, *cash-out* and *Black-Scholes* values of vested and unvested options), but it also ***explains*** what those values ***mean.***

Section 2 of the report looks at possible changes in those values, based on hypothetical changes in the price of the underlying stock. In the Sample case (below), a 20% decrease in the stock price translates to a 41% loss in the ***time and risk/adjusted values*** of the options portfolio!

		Based on Current Portfolio of Vested and Unvested Options					
Potential Future Stock Price	Incremental Change	ITM Value	Incremental Change	Black-Scholes Value	Incremental Change	Cash-out value	Incremental Change
$20.27	-20.0%	$243,624	-37.7%	$421,595	-43.7%	$146,175	-37.7%
$25.33	-20.0%	$390,769	-42.0%	$748,495	-39.4%	$234,461	-42.0%
$31.67	-20.0%	$673,999	-47.9%	$1,234,506	-35.8%	$404,400	-47.9%
$39.58	-20.0%	$1,292,862	-41.5%	$1,924,226	-33.0%	$775,717	-41.5%
$49.48		$2,208,849		$2,871,949		$1,325,310	
$59.38	20.0%	$3,276,667	48.3%	$3,877,917	35.0%	$1,966,000	48.3%
$71.25	20.0%	$4,624,197	41.1%	$5,130,261	32.3%	$2,774,518	41.1%
$85.50	20.0%	$6,241,914	35.0%	$6,673,199	30.1%	$3,745,148	35.0%
$102.60	20.0%	$8,183,174	31.1%	$8,557,164	28.2%	$4,909,904	31.1%
$123.12	20.0%	$10,512,687	28.5%	$10,843,683	26.7%	$6,307,612	28.5%

It's important to note that this report is merely a "snapshot" of the client's holdings, and their value ***at one point in time.*** As values change, the report will become outdated. ***Periodic updating and review is essential.*** Fortunately, this point is easily made and understood, particularly when reviewing the "Incremental changes" columns in the chart above.

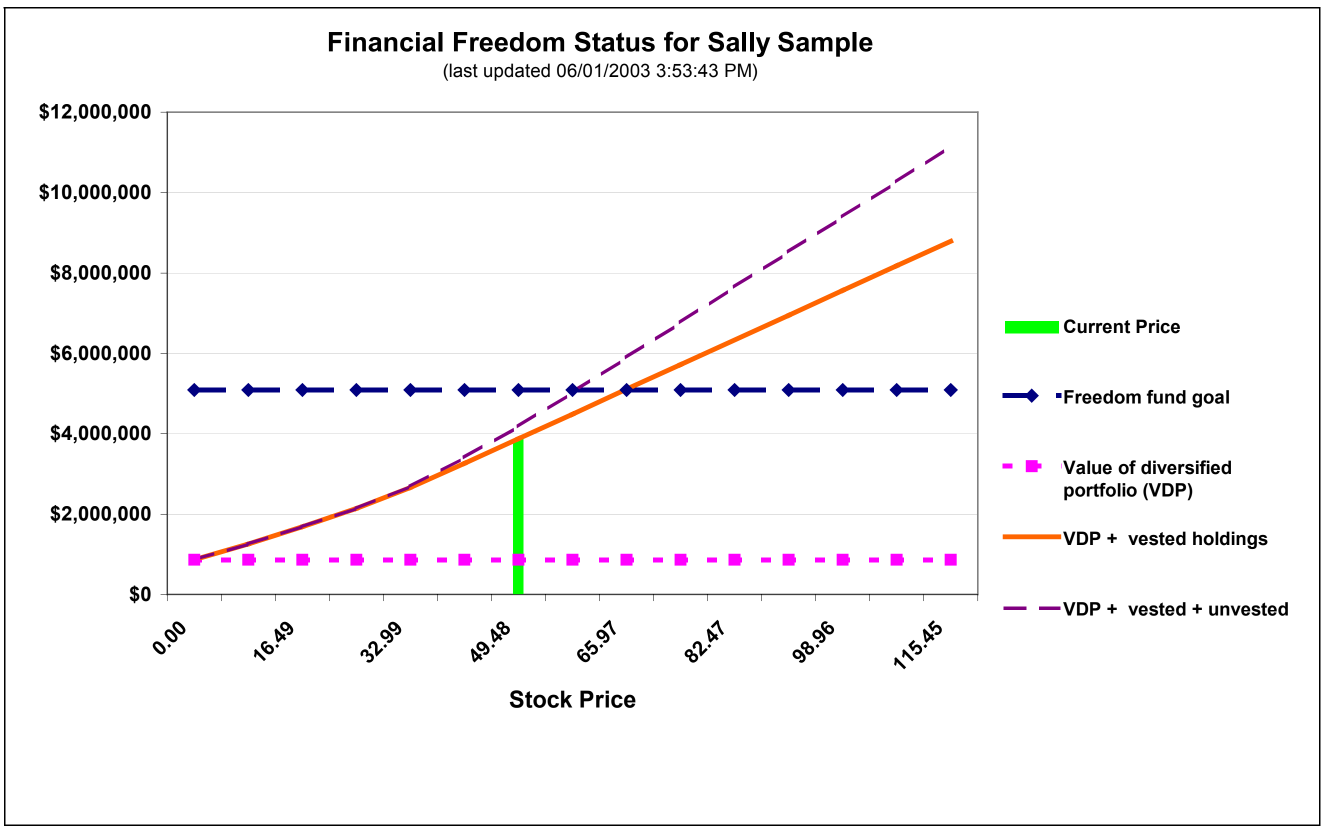
The ***Black-Sholes Values*** in that chart provide some ***very*** useful insight (which is, after all, The Name Of The Game) into the relationship of "value" (as in "what are my options ***worth***?") to ***risk.*** For example, even options that are "under water" may have positive Black-Scholes Value, because (as the report states) "*there is a possibility that the stock price will rise above the strike price of the option prior to its expiration. In fact, the higher the volatility of the stock and the longer the time until expiration, the more likely that this will occur.*"

A second point the advisor will wish to make, if the report shows differences between the "In The Money Value" and Black-Scholes Value is (again, using the actual words of the report) that "*the difference between the Black-Scholes value and the in-the-money value is referred to as the "time value" of the option. The time value is a measure of the potential value of an option and has the following characteristics:*

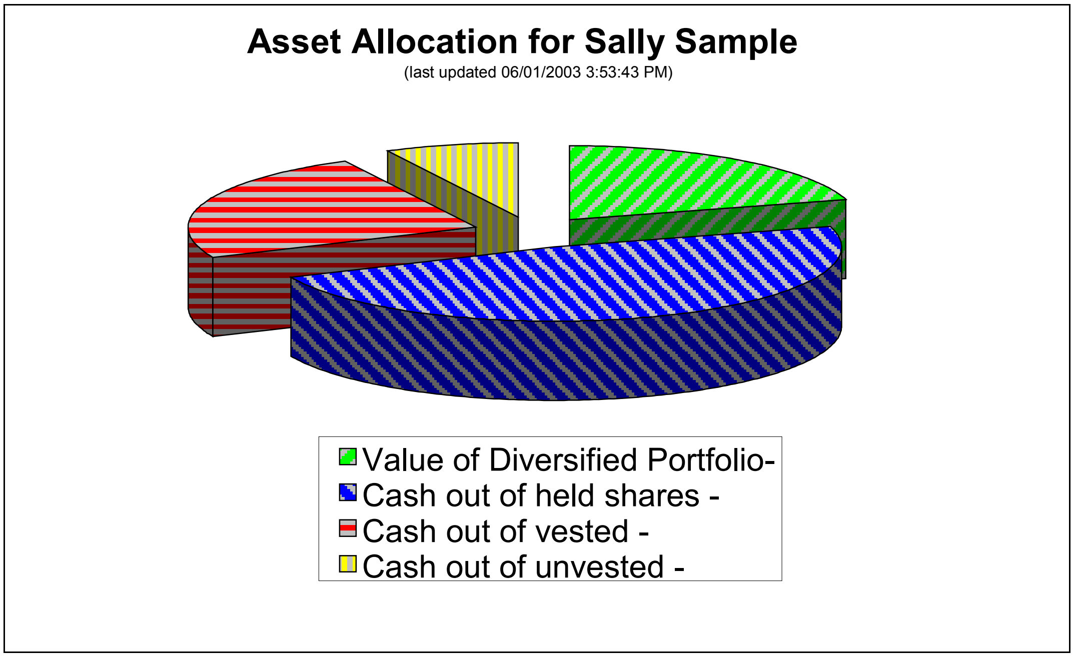
- **The time value decreases as the expiration date approaches.**
- **The time value decreases as the in-the-money amount increases.**
- **The time value is higher for stocks with higher volatility**."

In short, when the situation has changed to the point where there is more ***downside risk*** than ***upside potential***, it may be time to make changes.

Section 3 (the "Freedom Fund Analysis") is one of the slickest, most easily understood presentations this planner has ever seen. It relates the client's "financial freedom goal" (that amount of capital required to produce a specified level of income, without touching principal) to the sum of the client's option holdings and other investments (the "value of the diversified portfolio" (VDP)), not over time, but ***as a function of the price of the employer's stock*** (see chart below).



Next, the report addresses the ***concentration risk*** (see graph below)



and includes a ***Value at Risk*** computation –

"Value at Risk Analysis

In an attempt to further identify and convey the risk in your company stock and option position, we have adopted the Value at Risk (VaR) methodology used by many financial institutions to determine their exposure to negative economic events. VaR is computed using the same volatility used in the Black-Scholes calculations. Using this methodology, under normal market conditions there is a 5% chance that you could lose **$770,189** or more of the total in-the-money value of your company stock and vested options of **$4,046,740** during the next 30 days. Please pay close attention to the phrasing "under normal conditions" and "or more". VaR methodology generally cannot provide an estimate for the size of losses in those scenarios where the VaR threshold is exceeded. It is possible that you could lose the entire cash-out value of your vested, in-the-money options and stock."

In Section 4, the report describes the ***monitoring functions*** that the advisor is prepared to offer the client. In addition to keeping track of ***vesting*** and ***expiration dates***, the advisor offers (using the StockOpter® *Insight* tool), monitoring of key values and ratios. (as shown in the following excerpt).

"Key Monitoring Ratios:

- **Time Value / Value at Risk**: This ratio shows the Time Value divided by the Value at Risk remaining for each vested grant. As we have seen, the time value of an option decreases over its term, while the value at risk increases if the stock price rises. Therefore, the lower the TV/VaR percentage, the more compelling is the argument for diversifying the option. While the value of this ratio could theoretically be infinitely large, it is small values that are of interest. Therefore, a 1000% ceiling has been placed on this ratio.

- **Time Value / Black-Scholes Value**: This ratio shows the Time Value divided by Black-Scholes value for each vested grant. As your options approach expiration, or as the stock price increases (if the option is or becomes in the money) this percentage will decrease. This ratio can be used to help you determine when the value of holding the option is low compared to exercising and selling. Like the TV/VaR ratio, the lower the TV/BSV percentage, the more compelling the argument for taking action."

Grant ID	Option Type	Expiration Date	Strike Price	Time value	VaR	Time Value / VaR	BSV	Time Value / BSV
ISO1	ISO	02/15/04	$11.03	4,379	73,526	**5.96%**	548,346	**0.80%**
ISO2	ISO	02/16/05	$12.73	11,515	75,681	**15.22%**	546,350	**2.11%**
ISO3	ISO	01/15/08	$29.18	68,579	68,805	**99.67%**	334,231	**20.52%**
NQ1	NQSO	01/15/08	$29.18	63,168	63,377	**99.67%**	307,861	**20.52%**
NQ2	NQSO	03/05/09	$36.43	52,423	30,452	**172.15%**	126,966	**41.29%**
NQ3	NQSO	12/18/12	$52.15	0	0	**0.00%**	0	**0.00%**
Grand Total				200,064	311,840		1,863,754	

4. After the advisor's review of the ***Personal Option Profile Report***, the advisor may offer the client an ongoing ***monitoring*** service. Whether this option is elected (and offered) or not, the client probably has, at this point, a much better understanding of the potential rewards ***and risks*** inherent in her ESO portfolio. If the client's concentration in one security (the employer's stock) is deemed excessive, the advisor may recommend diversification – perhaps an ongoing, ***planned*** program of diversification. In any event, the advisor has, using StockOpter® *Insight*, demonstrated to the client the value, not only of prudent ESO planning, but also of an ***ongoing relationship*** with an advisor who can help the client do such planning.

For years, this writer has been proclaiming that financial planning is not about ***analysis***; it's about ***relationship.*** StockOpter® *Insight* is a tool which clearly understands this.

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