

# Sample

## *Stock Option Diversification Analysis*

For

**Conrad Anderson**

Provided by

**Joe Advisor**

Following is a sample stock option analysis created by using output from StockOpter Pro and pasting it into a Word document. It compares 2 different diversification scenarios using two different stock price growth assumptions for the client's tax situation. The objective is to show the client the after-tax cash flow results of different alternatives so as to make an informed decision. For more information visit [www.networthstrategies.com](http://www.networthstrategies.com) or call 877-728-5964.

Date

Conrad Anderson  
1313 Mockingbird Lane  
Anytown, USA 10001

Dear Conrad:

It has been a pleasure working with you to develop a initial stock option plan. The attached report represents our analysis and concludes the engagement of our services.

The purpose of this stock option plan is to enable you to understand the risks, establish goals, and begin to take action. It is your obligation and responsibility to review the report for accuracy and completeness, and to determine how this analysis will best fit with your overall financial goals. I recommend that you review this plan with your tax planning professional.

We have relied on the assumption information you provided to prepare this report. These assumptions are included as Appendix A. Your grant information is summarized in Appendix B. Errors in this information will affect the accuracy of the results.

If you have any questions, please call us at (541) 383-3899.

Sincerely,

Joe Advisor

# Stock Option Analysis Report

<b>Client:</b> Conrad Anderson	<b>Company:</b> Yahoo
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## Analysis:

The approach taken was to compare the results of a concentrated (non-diversified) strategy to the results of a diversification strategy that incorporates your goal. This was accomplished by comparing these two strategies against two different price performance scenarios. The two annual price performance assumptions made were 12% and 5%.

**Strategy 1:** The options were held until expiration. At the time of expiration, all remaining inventory of options were exercised (if in the money) and the necessary number of shares sold to cover the purchase cost and tax liability of the exercises.

**Strategy 2:** 25% of the available inventory (unrestricted shares held plus vested, in-the-money options) was sold each year. Options were exercised on an as-needed basis to provide shares for diversifying sales.

## Findings:

As shown by the Stock Price Sensitivity Chart below a strategy of diversifying 25% of the available inventory annually results in a significant reduction of risk inherent in holding a concentrated stock or stock option position. The reduction in risk is represented by the significant decrease in discrepancy between the alternative stock price performance scenarios.

The performance of the “as late as possible, sell to cover,” strategy in BaseCase, represented by the red line on the Chart is the most optimistic result assuming a 12% growth rate. By contrast, the worst performing strategy represented by the gray line is the same strategy using a 5% growth rate. The risk of this approach is reflected in the difference between each of these alternative scenarios. The detail of these cases is provided below.

In contrast, the diversified strategy represented by the blue and green lines on the Stock Price Sensitivity Chart demonstrates the substantially reduced risk provided through diversification. Note the significantly reduced discrepancy between the Total Portfolio Values in the diversified strategies using the same 12% and 5% growth rates. The detail of these cases is also provided below.

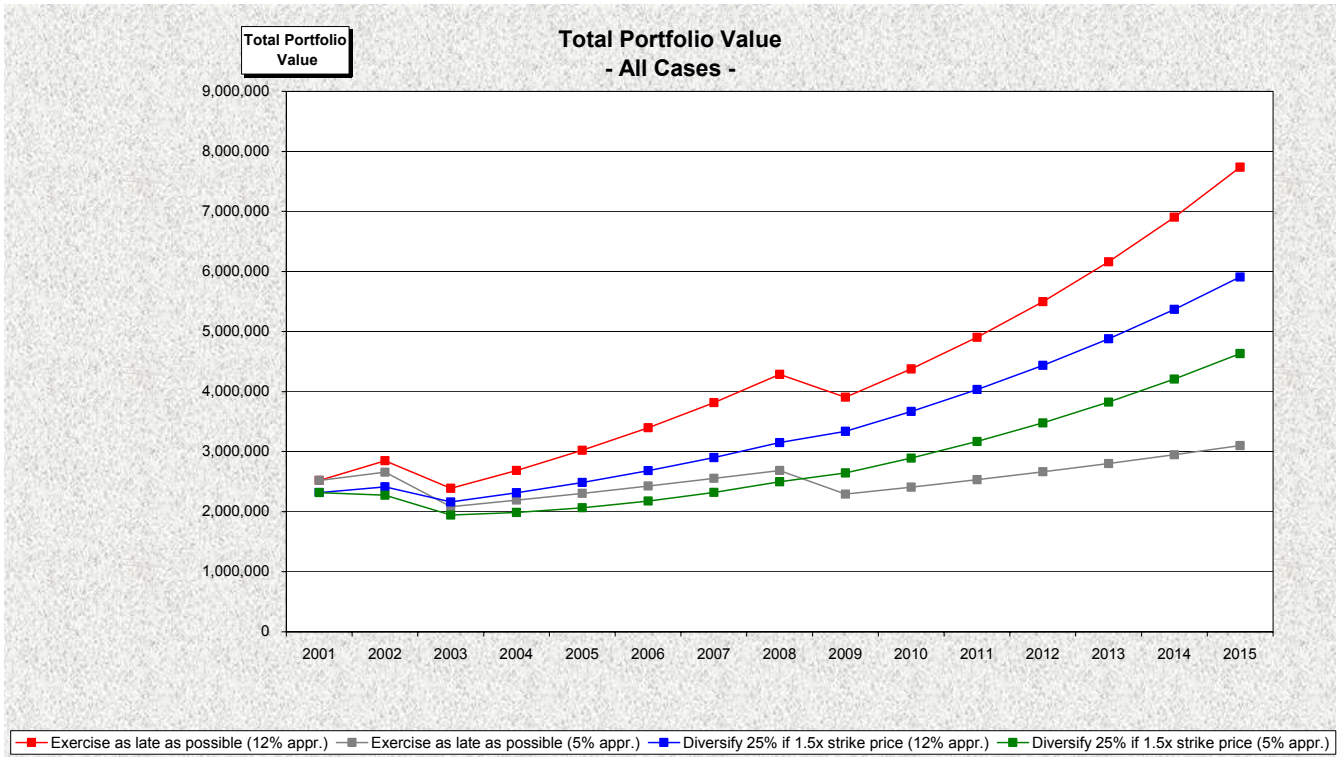
To further illustrate our findings we have included a Diversification Comparison Chart. This chart also compares a 25% annual diversification strategy (green bar) to a strategy that exercises and sells as late as possible (blue bar), but it applies the historical stock performance of IBM, AT&T, and Apple. The bars represent the total value of the client’s option portfolio at the end of 15 years.

## Conclusions:

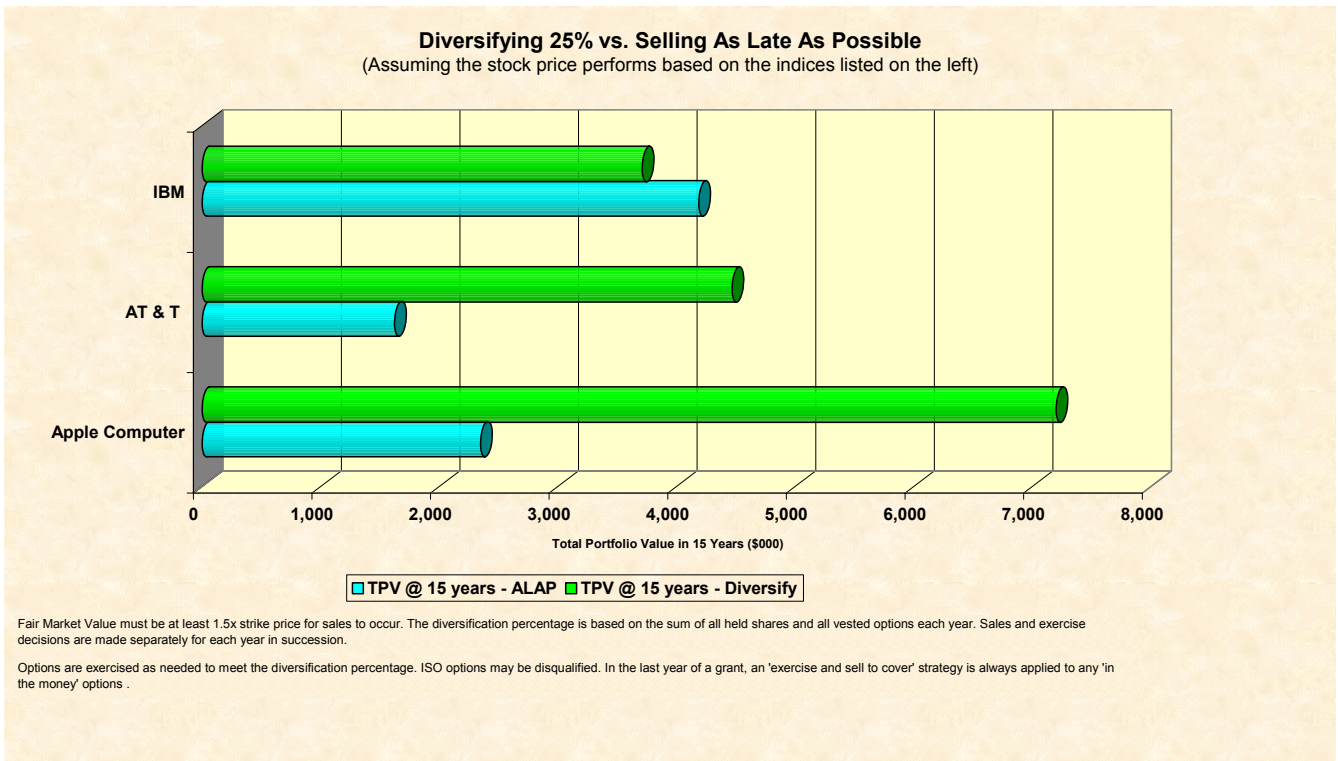
- This information relies upon the accuracy of information and data you provided to us. This information is represented in **Appendix A** (Assumption Details) and **Appendix B** (Grant Summary Information). Please review these attachments for accuracy.

- Calculations of performance are estimates only, and actual results may vary from the figures shown. All rates of return are **hypothetical** and are not a guarantee of future performance of any asset.
- Stock option planning provides both opportunities and challenges. The main purpose of this information is to help you to identify your goals and your tolerance for risk.
- This report models a 25% diversification strategy. This strategy may or may not be the most appropriate strategy for you.
- As with other types of financial planning, stock option planning is a process and not a product. Regardless of the strategy employed, stock option planning requires continuous monitoring, with particular focus on your goals and the performance of the underlying stock.
- You should consult your tax advisor for additional feedback on how this basic diversification strategy will specifically affect your situation.

# Stock Price Sensitivity Analysis



## Diversification Comparison Chart



## Case Comparison Details

### BaseCase – Exercise As Late As Possible, Sell to Cover

This strategy is designed to project the results if you were to exercise all options as late as possible, sell-to-cover and hold the remaining shares indefinitely. It is intended to model a typical strategy of failing to diversify your option assets. Option holders typically will do this if they are over-confident of their stocks future performance or they are procrastinating due to the complexity of options.

- Options were exercised as late as possible (ie- in the year of expiration) and held.
- The exercises were financed by selling enough of the currently exercised NQ shares to cover the strike price and associated taxes.
- The assumed annual appreciation of the underlying stock was **12%**.
- Resultant TPV at the end of the model was \$7,735,536.

### Case2 – Exercise As Late As Possible, Sell to Cover

This strategy is the same as that in BaseCase, adjusted for the alternative price performance scenario of 5% annual growth.

- Options were exercised as late as possible (ie- in the year of expiration) and held.
- The exercises were financed by selling enough of the shares to cover the strike price and associated taxes.
- The assumed annual appreciation of the underlying stock was **5%**.
- Resultant TPV at the end of the model was \$3,099,508 at net risk of \$4,636,028.

### Case3 – Diversify 25% of the available inventory each year

This strategy was designed to reflect a diversification strategy. This type of approach is often used to help minimize the risk associated with holding a concentrated position in a single stock.

- Options were exercised and shares sold in adequate numbers to meet the diversification goal of 25% per year.
- Shares were only sold if the market price was greater than 1.5 times the exercise price.
- The assumed annual appreciation of the underlying stock was **12%**.
- Resultant TPV at the end of the model was \$5,909,317.

#### **Case4 – Diversify 25% of the available inventory each year**

This strategy is the same as that in Case3, adjusted for the alternative price performance scenario of 5% annual growth.

- Options were exercised and shares sold in adequate numbers to meet the diversification goal of 25% per year.
- Shares were only sold if the market price was greater than 1.5 times the exercise price.
- The assumed annual appreciation of the underlying stock was **5%**.
- Resultant TPV at the end of the model was \$4,631,414 a net risk of only \$1,277,903.

## ALAP Strategy Details

<b>ISO Label:</b> ISO #1 -- Name/ID:		<b>ISO Name:</b> ISO 09 \$2.50				
<b>Date of grant</b>	01/01/1999	<b>Grant expiration date</b>	01/01/2009	<b>Exercise price</b>	\$2.50	
Year	Vesting schedule (1/1)	Options available for exercise (1/1)	Qualified options exercised	Disqualifying disposition	Shares available for sale as qualified (1/1)	Shares sold (qualified)
2001	0	16,000	0	0	0	0
2002	8,000	24,000	0	0	0	0
2003	8,000	32,000	0	0	0	0
2004	8,000	40,000	0	0	0	0
2005	0	40,000	0	0	0	0
2006	0	40,000	0	0	0	0
2007	0	40,000	0	0	0	0
2008	0	40,000	0	0	0	0
2009	0	40,000	26,556	13,444	0	0
2010	0	0	0	0	26,556	0
2011	0	0	0	0	26,556	0
2012	0	0	0	0	26,556	0
2013	0	0	0	0	26,556	0
2014	0	0	0	0	26,556	0
2015	0	0	0	0	26,556	0

<b>NQSO Label:</b> NQSO #1 -- Name/ID:		<b>NQSO Name:</b> NQ 03 \$2.00			
<b>Date of grant</b>	01/01/1998	<b>Grant expiration date</b>	01/01/2003	<b>Exercise price</b>	\$2.00
Year	Vesting schedule (1/1)	Options available for exercise (1/1)	Options exercised	Shares available for sale	Shares sold
2001	0	50,000	0	0	0
2002	0	50,000	0	0	0
2003	0	50,000	50,000	50,000	24,443
2004	0	0	0	25,557	0
2005	0	0	0	25,557	0
2006	0	0	0	25,557	0
2007	0	0	0	25,557	0
2008	0	0	0	25,557	0
2009	0	0	0	25,557	0
2010	0	0	0	25,557	0
2011	0	0	0	25,557	0
2012	0	0	0	25,557	0
2013	0	0	0	25,557	0
2014	0	0	0	25,557	0
2015	0	0	0	25,557	0

## Diversification Strategy Details

<b>ISO Label:</b> ISO #1 -- Name/ID:			<b>ISO Name:</b> ISO 09 \$2.50			
	<b>Date of grant</b>	01/01/1999	<b>Grant expiration date</b>	01/01/2009	<b>Exercise price</b>	\$2.50
<b>Year</b>	<b>Vesting schedule (1/1)</b>	<b>Options available for exercise (1/1)</b>	<b>Qualified options exercised</b>	<b>Disqualifying disposition</b>	<b>Shares available for sale as qualified (1/1)</b>	<b>Shares sold (qualified)</b>
2001	0	16,000	0	4,000	0	0
2002	8,000	20,000	0	5,000	0	0
2003	8,000	23,000	0	5,750	0	0
2004	8,000	25,250	0	6,313	0	0
2005	0	18,938	0	4,734	0	0
2006	0	14,203	0	3,551	0	0
2007	0	10,652	0	2,663	0	0
2008	0	7,989	0	1,997	0	0
2009	0	5,992	4,494	1,498	0	0
2010	0	0	0	0	4,494	1123.48938
2011	0	0	0	0	3,370	842.617035
2012	0	0	0	0	2,528	631.962776
2013	0	0	0	0	1,896	473.972082
2014	0	0	0	0	1,422	355.479062
2015	0	0	0	0	1,066	266.609296

<b>NQSO Label:</b> NQSO #1 -- Name/ID:			<b>NQSO Name:</b> NQ 03 \$2.00			
	<b>Date of grant</b>	01/01/1998	<b>Grant expiration date</b>	01/01/2003	<b>Exercise price</b>	\$2.00
<b>Year</b>	<b>Vesting schedule (1/1)</b>	<b>Options available for exercise (1/1)</b>	<b>Options exercised</b>	<b>Shares available for sale</b>	<b>Shares sold</b>	
2001	0	50,000	12,500	12,500	12,500	
2002	0	37,500	9,375	9,375	9,375	
2003	0	28,125	28,125	28,125	7,031	
2004	0	0	0	21,094	5,273	
2005	0	0	0	15,820	3,955	
2006	0	0	0	11,865	2,966	
2007	0	0	0	8,899	2,225	
2008	0	0	0	6,674	1,669	
2009	0	0	0	5,006	1,251	
2010	0	0	0	3,754	939	
2011	0	0	0	2,816	704	
2012	0	0	0	2,112	528	
2013	0	0	0	1,584	396	
2014	0	0	0	1,188	297	
2015	0	0	0	891	223	

# Assumption Details

Assumptions	2001	2002	2003
<b>Names</b>			
Client name	CONRAD ANDERSON		
Name of corporation issuing plan	YAHOO		
Relationship with issuer *	1		
* (1-employee; 2-independent contractor)			
<b>Current / Future Year Information</b>			
Filing status*	2		
Number of exemptions	2		
<b>Income:</b>			
Salaries and wages (option holder)	81,152		
Salaries and wages (spouse)	0		
Self-employment income (option holder)	0		
Self-employment income (spouse)	0		
Investment income	0		
Long-term capital gain (loss)	0		
Other income	0		
Adjustments to gross income	0		
<b>Itemized deductions:</b>			
Deductible taxes, excluding state income tax	0		
Interest paid on home equity loans	0		
Investment interest expense	0		
Other investment expense, excluding investment interest	0		
Other itemized deductions, excluding state income tax	14,200		
<b>AMT adjustments &amp; preferences (not listed above):</b>			
Exclusion items	0		
Deferral items	0		
* 1 = Single; 2 = Married Filing Jointly; 3 = Married Filing Separately; 4 = Head of Household; 5 = Qualifying widow(er)			
<b>Stock Price Information</b>			
Initial stock price (1/1 of the first year of model)	\$27.00		
Estimated annual appreciation of stock price	12.00%		
Update "Estimated stock price 12/31" [Row 2] on all Case Sheets			
<b>Stock Dividend Information</b>			
Per share dividend (1/1 of first year of model)	\$0.00		
Estimated annual appreciation of dividend	0.00%		
Update "Estimated per share dividend" [Row 3] on all Case Sheets			
<b>First Year of Model</b>			
Initial year for StockOpter model	2001		
<b>Prior Year Information</b>			
Minimum tax credit carryforward	\$0		
Capital loss carryforward	\$0		
Investment interest carryforward	\$0		
Capital loss carryforward - AMT basis	\$0		
Investment interest carryforward - AMT basis	\$0		
<b>Estimated Tax Rates</b>			
Capital gains rate (override)			
Average state income tax rate	9.00%		
State taxable income adjustment	3,000		
Estimated inflation/escalation rate for tax-related values	0.00%		
<b>Investment Account</b>			
Annual dividends	2.00%		
Capital gains distributions	3.00%		
Appreciation	7.00%		
Interest (loan) rate for negative balances	9.00%		

Appendix A

## Grant Summary Information

### Initial Inventory

Plan Label	ISO #1	NQSO #1
Plan Name	ISO 09	NQ 03
Grant date	\$2.50	\$2.00
Expiration date	1/1/99	1/1/98
Exercise Price	1/1/09	1/1/03
Avail AMT Adj / Cum Cost Basis*	\$2.50	\$2.00
# Unvested options	0	0
# Vested shares	24,000	0
# Exercised and unsold shares	16,000	50,000
	0	0
<b>Vesting schedule</b>		
2001	0	0
2002	8,000	0
2003	8,000	0
2004	8,000	0
2005	0	0
2006	0	0
2007	0	0
2008	0	0
2009	0	0
2010	0	0
2011	0	0
2012	0	0
2013	0	0
2014	0	0
2015	0	0

\* For ISOs, this is Available AMT Adjustment before sale, for NQSOs and RSPs this is Cum Cost Basis before sale.