I learned warrant trading from a master of the Wall Street game. I was able to use that knowledge to pay cash for my very first new car and put a down payment on a house.

I wrote this eBook for a few reasons. First, I love to see people make money in stocks, almost as much as I like making it myself. Second, I could find very few books available on warrants, and none that actually talked about trading and the concepts I discuss here. And third, because I was tired of saying the word "warrant" at social gatherings and seeing that deer-in-the-headlights expression (though I think that will probably keep happening).

The purpose of this eBook is to help you understand what warrants are and how you can make money trading them. My hope is that this book will guide you as you explore the world of stock warrants. Trading warrants has greatly contributed to my portfolio, and I know you can profit from trading them as well.

Thank you for purchasing this eBook, and I sincerely wish you good luck in your trading!

Cheers,

Steven Adams

If at any point while you're reading this eBook you have any questions, please don't hesitate to contact me. You can best reach me at stevenadams@stockwarrantshq.com. Even if you don't have any questions, I'd love for you to come by and say hello at www.stockwarrantshq.com.

INTRODUCTION

My wife and I were driving into Jersey City, NJ for the first time, it was November 1997. The windshield wipers didn't make a dent in the tropical storm that was pelting us. We were having a little trouble finding the corporate housing. I had taken a job as an assistant equity trader a few weeks earlier, and my new firm was providing housing for a month.

When we finally found the high rise apartment building, we managed to soak both our luggage and ourselves as we struggled to unload our little Ford Escort. It was only the next day, as we were asking ourselves what the hell we had done moving to New York City, that we found our corporate apartment had a wonderful view of the Statue of Liberty.

Over the years I've found again and again that learning to trade new instruments, or new styles, often begins the same way that weekend began for my wife and I back in 1997. You don't know where you're going, the journey itself may not be a lot of fun, and as you get closer to your destination you question why you're doing what you're doing. But most of the time, not always, but most of the time, once you arrive at your destination there's a pretty nice view to enjoy.

Learning to trade warrants is no different. The overall concept of warrant trading and arbitrage is fairly simple. Like driving from DC to NY is fairly simple. But if you take a wrong turn and lose your way, the simple becomes frustrating at best and costly in terms of both time and money at worst.

If you've decided to journey into the profitable world of warrant trading and arbitrage, let this book be your detailed map and navigation aid. I'll show you how you can not only profit from warrant trading, but do so with limited risk to your trading account. If you're willing to put in some time, learn the strategies detailed here, and be vigilant for trading opportunities that arise, you will be very happy to have undertaken this profitable excursion.

So, let's get to it and make some money trading warrants! First we'll talk about what warrants are. Then we'll get into some of the trading strategies you can use with warrants. We'll follow that with some special situation trading involving warrants, including warrant expirations and trading SPAC warrants. And finally we'll look at a case study and what it teaches us about warrant expirations.

WHAT ARE WARRANTS?

CAVEATS & GROUND RULES

Before we get into the nitty-gritty of defining what warrants are, let's clarify a few items so there won't be any confusion around what we're discussing. First, there are several flavors of warrants. Some are issued as part of bond offerings, some are issued in private placements, some are issued in order to arrest bad guys, and some are publicly traded on stock exchanges. We will ONLY be talking about those that are publicly traded on stock exchanges…don't use this book as a guide to getting your cousin Albert out of those 50 parking tickets.

Second, in some money management circles, and among the vast majority of individuals I talk to, there seems to be a clear bifurcation between *investing* and *trading*. Investors look down on traders for their short term attitude, and traders think investors are idiots for "buying and holding" a stock as the price gets cut in half. That's another book (or maybe 10 books) in itself. For our purposes the strategies we discuss aim to be profitable in a very short amount of time, and are trades, not investments.

In that vein, I'll provide you with several low risk strategies that work very well given that you buy a stock on a certain day and sell it within a few days after the purchase. However, sometimes these strategies do not work as planned. If you just speed read the last sentence, go back and speed read it a few more times. Please, and I say this from much experience and with your wallet in mind, do not suddenly become an expert on stock described in the strategies that follow, *know* that it is going to triple in the next five years even though it did not adhere to the predicted pattern, and decide you're going to add it to your core stock holdings.

If you buy a stock based on a certain strategy – this goes for the warrant trading strategies explained here, or if you bought it because Warren Buffet did, or if you just know the company is going to win that big contract – and, if the strategy does not follow the predicted pattern – or Buffet sells the stock, or they don't get the big contract – then exit the position. You are not an expert on the long term value of the stock just because you took a short term position in it! OK, with that out of the way, let's move on to the meaty stuff.

Warrant Issuance

Many people ask me why warrants are issued in the first place. Warrants can be issued for a large variety of reasons:

- Warrants can be issued when a company goes public as a capital raising instrument, so that the warrants begin trading at the same time as the stock IPO
- Warrants can be issued after a company is public, to raise additional capital
- A court may order the issue of warrants as part of a settlement or decision of the court, and
- Warrants may be granted in a takeover or spinoff

Warrants are generally issued with an expiration date that is between three and five years of the original issue date. There may also be a time period immediately after issue in which the warrants are not exercisable.

For example, a warrant may be issued with this description: "This warrant is exercisable for a term of three years beginning six months from the issue date." The goal of the company issuing the warrants is to have them exercised, bringing additional capital to the company.

Warrants Defined

At the simplest level, warrants are trading instruments whose value is based upon another trading instrument. Usually this is the underlying stock, but it can also be a combination of the underlying stock and another trading instrument, such as another warrant. All stock warrants are defined by their terms. The warrant will be *exercisable* for some defined period of *time* at a predetermined *price*.

So let’s look at each of those terms, starting with exercising a warrant. When you exercise a warrant you give the warrant back to the company that issued the warrant, usually along with some amount of cash, and in turn the company gives you some predetermined number of common shares in the company.

When you exercise a stock warrant the cash you provide as part of the exercise process goes directly to the company whose warrant you are exercising. For example, if the "exercise terms" are "$5 plus one warrant is exercisable for 1 share of common stock," then in exchange for the warrant you own and $5, the company will issue you one share of their common stock. The company is now $5 richer, and you own stock instead of warrants.

Warrants are exercisable for a defined amount of time, usually 3-5 years. But, very importantly, a warrant must have a current registration in place with the SEC in order to be exercisable. The company issuing the warrant must file this statement. If you own a warrant that you would like to exercise, and there is no current registration statement in place, you can contact the issuer and ask that they file a registration statement.

Practically, a warrant may have a current registration statement, allowing for the exercise of the warrants, and when the registration lapses the issuer can no longer accept the warrants and issue stock. This means a warrant can be exercisable one week and not exercisable the next. The market result is usually a decrease in the value of the warrants until a new registration is filed.

If we have a hedged position (we’ll cover this in detail below) we will be long warrants and short common stock. If we have this position and the warrants, that were exercisable, can no longer be exercised, two things will likely happen. First, the value of the warrant will decrease. This is our long position and we will lose money. Second, the stock will likely go up as everyone who has on the same position tries to cover their shorts. We will lose money on both sides of the trade. So, losing money on both sides of a hedged position = vacationing at Myrtle Beach instead of the Caymans.

There is a fairly simple tactic we can use to avoid this situation. You'll definitely want to employ this tactic if you have a large hedged position in a warrant. Here it is: Periodically exercise a few of your warrants. In order to be 100% sure the warrants are exercisable you can simply exercise them. If you trade a number of warrants, at some point in your trading, this strategy will save you a great deal of money.

Periodically exercise a few warrants to ensure they are exercisable and the registration statement is current.

Finally, each warrant has exercise *terms*. These are as varied as the number of warrants trading, and are the essence of understanding and profiting from warrant trading. These terms will be clearly defined in SEC filings made by the issuing company.

The most basic exercise term will simply provide a dollar amount and number of warrants required to receive a set amount of common stock. For example, "one warrant plus $5 will be exercisable for one share of common stock." Send the company one warrant and $5, and a share of common stock will be transferred into your brokerage account.

More complicated terms will include:

- Issuance of a fractional number of common shares
- The requirement for a fractional number of warrants to receive shares
- A combination of several warrants with intertwined exercise terms (e.g. "two class A warrants, plus one class B warrant, plus $4.25 may be exchanged for 1.75 shares of common stock"), and

- Issuance of some combination of common stock and another instrument (preferred stock, convertible stock, bonds) in exchange for a warrant plus some amount of cash

Whatever the warrant terms, it is essential to both clearly understand the terms, and verify that the warrants are currently exercisable. Warrant terms must also be constantly monitored, as unlike listed option contracts, the issuing company can change the terms of the warrant. While this is unusual, it is not unheard of, and under certain circumstances can almost be expected.

For example, if a warrant is approaching its expiration date and it is out-of-the-money, it is not unusual for the company to modify the warrant terms. They can either extend the expiration date, change the exercise terms so the warrant becomes either at or in-the-money, or both.

And finally, where do you find a warrant's terms? As mentioned above, the terms are published in the company's SEC filings and can usually be found using EDGAR, the SEC public database. You can also speak to your broker, or find the terms on the company's own website under "investor relations". You may also want to email the investor relations department of the company and ask for the current warrant terms.

TRADING WARRANTS

As I mentioned above, our focus in warrant trading is on arbitrage and short term trading patterns that occur in the common stock and warrants of publicly traded companies. Below we'll take an in depth look at both types of trading. But before we get into the *how* of warrant trading let's spend just a minute on the *why*.

There are many types of trading instruments – equities, options, weekly options, commodities, FX – and many more trading strategies – buy and hold, value, momentum, etc. I've traded many of the instruments, and I'm fairly knowledgeable on many of the strategies. So why do I find warrant trading particularly appealing? Three things:

1. **Limited risk**
2. **High relative return**
3. **A defined time period**

Warrant arbitrage and the warrant trading patterns I'll detail here offer all three. It may not be the sexiest way to trade, but give me a trade that meets these three criteria and I'll take it every single time. Now let's talk trading.

First, we'll take a deep dive into warrant arbitrage and then in the next chapter we'll detail the warrant expiration pattern. We'll segment arbitrage into three distinct parts that make it easy to understand:

1. Classic warrant arbitrage
2. Trading around a hedged warrant position, and
3. Trading a hedged warrant position using a percentage hedge

CLASSIC WARRANT ARBITRAGE

Classic arbitrage involves buying a warrant and simultaneously selling short either the common stock or an option on the common stock. Let's take an example of a warrant with a very simple and straightforward exercise term.

Our warrant can be exercised for $5 to get one share of common stock. Therefore, if the common stock is trading at $10 the warrant should logically trade at a minimum of $5. One warrant trading at $5, plus an additional $5 of cash, is equal to the value of the stock at $10.

Normally the warrant will trade above $5 because the warrant will trade with a time premium just as an option does. The longer the period of time until expiration the higher the premium.

There can also be additional premium factored into the warrant based on expectations and volatility of the underlying stock. For some warrants, those that trade a high amount of volume and that have an underlying that also trades a high amount of volume, a pricing model, such as the Black-Sholes or a similar model, can be used in determining the appropriate price range.

While it is less frequent today than it was even ten years ago, there are rare times when there is no premium in the warrant, and the warrant trades at a discount to the common. For our example, this would mean the common is trading at $10 and the warrant is trading at some price less than $5.

When this happens, the trade is fairly simple. Buy the warrant at less than $5 and short the common at $10.

Let's say we can buy the warrant at $4.75 and short the common at $10. We've now made a guaranteed $.25 on the trade. If necessary you can simply exercise the warrant and receive common stock to cover your short position in the stock.

By sending $5 to the company along with the warrant we purchased for $4.75 we will receive one share of common which will offset our short position which we established at $10. Net result, we've sold common stock at $10 and are now covering that short at $9.75 for a $.25 gain.

The Warrants Must Be Exercisable...

Now, don't rush out and find a warrant that is trading at a discount and believe you've found Blackbeard's treasure. There are two very important caveats to this trade. First, the warrants must be exercisable.

If you find a situation where a warrant is trading at a substantial discount to the price of the common stock (meaning the price of the warrant plus the exercise amount is substantially less than the current value of the common stock) it is highly likely that the warrant is not exercisable.

How do we handle this situation? First, we call our broker and ask if the warrant is exercisable. If they look it up on Bloomberg and see that it is exercisable, great, then we move to the next step.

Second, we call the transfer agent to ask if the warrant is exercisable. Your broker should be able to tell you who the transfer agent is for the warrant as well and you can get the telephone number for the transfer agent either from your broker or online. What the heck is the transfer agent?

When a broker is directed to exercise a warrant they do not actually send the warrant and money to the company itself. This back office function is performed by a transfer agent. I myself have dealt extensively with American Stock Transfer and Depository Trust & Clearing, or DTC.

This agent is tasked with ensuring the correct documents are filed by the company, getting the cash to the company, and getting the stock to your broker. The transfer agent should know if the warrants are covered by a current registration statement filed with the SEC, and therefore should know if the warrants are exercisable.

In a scenario where your broker and the transfer agent tell you the warrant is not exercisable, the third step is to contact the company that issued the warrant to ask if they will file a current registration statement in order to make the warrants exercisable.

Do not overestimate the level of knowledge around warrants, or stock, at the issuing company. I've personally spoken to a CFO who did not even know what exchange his company's warrants were trading on.

The CFO may not be aware that they need the registration statement. With a simple call (or email) you may be able to get the company to register the warrants in order for them to be exercisable.

THE STOCK CAN BE SHORTED (OR HAS OPTIONS)...

After we ensure the warrants are exercisable, next we find out if the stock can be shorted. If the stock is borrowable, we have no issue. Your broker should allow you to short the stock. Often stock is borrowable, but you may have to pay interest to borrow it. You must do the math to make sure this rate does not eat away all of your arbitrage profit.

If the stock cannot be shorted, a second option is to trade against your warrants using options (pun intended). Call options can be shorted against the common with the same profit of shorting the common. You'll be looking to short deep in-the-money calls with little to no premium.

However, and this is a very important caveat, shorting calls against warrants may not create the same hedge as shorting common stock. The hedge is only as great as the value of the option vs. the value of the warrant. Here's a quick example.

Let's assume you own a warrant that is trading at $10, the common is at $30, and the exercise price for the warrant is $20. (For this example we assume the warrant is trading at parity and that any options bought or sold short have no premium.) Let's look at two scenarios. In scenario one we'll short the $10 strike call for $20 and buy the warrant for $10. If the stock drops to $15 you'll make $15 on the short call and lose $10 (about, it won't quite go to $0) on the long option. You just made $5, Good result.

Scenario One

	Price		
	Establish position	Stock Moves Down	Profit / Loss
Common (no position)	$30	$15	N/A
Warrant	Long @$10	$0	-$10
$10 Strike Call	Short @ $20	$5	+$15
			$5 Profit

In scenario two we short the $25 strike call for $5 and buy the warrant for $10. If the stock drops to $15 this time we'll make $5 on the short call (again, it won't quite go to $0 if there is extrinsic value) and lose $10 on the warrant. Not a good result.

Scenario Two

	Price		
	Establish position	Stock Moves Down	Profit / Loss
Common (no position)	$30	$15	N/A
Warrant	Long @$10	$0	-$10
$25 Strike Call	Short @ $5	$5	+$5
			$5 Loss

So, shorting a call option (or alternatively buying a put option) can be used to replace shorting the common stock. But, if you use this strategy you must be aware of the actual value of the short position vs. the actual value of the long position.

Another drawback to this method is that the options you are short may be exercised, making you short the common. If this occurs your broker will likely have to go into the market and buy back the common because you cannot carry a short position in the stock. This may, and often does, eat into your arbitrage profit.

Trading Around a Hedged Warrant Position

It is not ideal to exercise a warrant to close a short position in the common, even if the position was originally put on at a profit. If you maintain the position there is an opportunity to make money as the position reverses, e.g. the common drops in price and the warrant retains value. But, there are times when it may be necessary to exercise the warrant.

You may need to exercise when you know you are going to be bought-in on your short position, or you need to use the capital the position is tying up for other purposes. But, if you can carry the position, you may have an opportunity to make further profit from what has already been a profitable trade.

Let's continue with our previous example and talk about how we can trade our hedged position.