



INVESTMENT STRATEGY

## Warrants as a Strategic Tool for Family Office Portfolios

Warrants when deployed thoughtfully, enhance returns, unlock access to private transactions, and align incentives across generations and investment partners—making them an increasingly valuable instrument for sophisticated family offices navigating today's complex investment landscape.

# Understanding Warrants: The Contractual Foundation

## Core Mechanics

A warrant grants the holder the right—but not the obligation—to purchase (or occasionally sell) a company's shares at a predetermined strike price before a specified expiry date. This contractual structure provides optionality whilst preserving capital flexibility.

## Critical Distinction

Unlike exchange-traded options, warrants are typically issued directly by the company. When exercised, they create new shares rather than transferring existing ones, introducing dilution implications.



# Why Family Offices Embrace Warrants



## Patient Capital Alignment

Warrants typically span 5–10+ years, perfectly matching multi-year or multi-generational investment horizons. This extended time frame allows families to benefit from long-term value creation without the pressure of near-term liquidity events.



## Private Market Access

Many Indian and global family offices allocate meaningfully to private markets and venture-style transactions. Warrants frequently attach to debt or equity instruments as an "equity kicker," providing enhanced economics in precisely the illiquid, growth-oriented deals these investors favour.



## Asymmetric Payoff Profiles

The convex return structure of warrants—substantial upside participation with capped downside—complements traditional family office mandates of capital preservation with measured growth, particularly when deployed alongside debt instruments or structured transactions.

# Risk Management & Governance Framework



1

## Concentration & Expiry Risk

Warrants can expire worthless if the underlying security never trades above the exercise price within the specified timeframe. Position sizing, tenor selection, and strike-level calibration must be approached conservatively.

2

## Dilution & Control Dynamics

Exercising warrants increases the share count and can materially alter control structures. Clear policies must govern when to exercise versus selling in secondary markets where liquidity exists.

3

## Rigorous Process & Reporting

Well-structured family offices maintain robust frameworks for valuing, monitoring, and stress-testing warrants alongside other private and alternative assets, ensuring integrated portfolio management rather than treating these instruments as isolated side bets.

# Warrants in Private Market Transactions

Family offices predominantly deploy warrants in private markets as an "equity kicker" attached to debt or structured equity. This approach bridges valuation gaps, secures additional upside in SPAC and growth transactions, and enhances returns on private credit and PE-style deals without committing substantial upfront equity capital—aligning perfectly with capital-preservation-plus-growth mandates.



## Venture Debt & Mezzanine

Warrants attached to loans allow family offices to purchase equity later at preset prices, sharing in long-term upside. This compensates for elevated credit risk whilst often enabling more flexible terms for the borrower.



## PE Deal Sweeteners

In private equity or growth rounds, warrants "sweeten" negotiations when founders are valuation-sensitive, granting additional shares if the company succeeds whilst requiring careful dilution modelling.



## Valuation Bridges

When investors and founders disagree on price, warrants can back-end pricing: the family office accepts a higher headline valuation but secures warrants tied to revenue or exit milestones.



## SPACs & Structured Exits

Family offices receive or purchase public/private placement warrants in SPAC transactions, providing leveraged upside on post-merger companies for several years, often more valuable than initial promote shares.

## Key Benefits

- Enhanced IRR from equity participation atop interest or preferred returns
- Improved alignment with founders and management teams
- Greater negotiating flexibility to structure mutually beneficial terms

## Principal Risks

- Complexity in structuring, valuation, and legal documentation
- Material dilution impacts on cap tables at exercise
- Expiry risk if milestones or price targets are not achieved
- Demands robust monitoring—many larger offices now build this capability in-house

# Taxation on Exercise: XYZ Ltd Case Study

This detailed example illustrates the complete lifecycle of warrant investment, exercise mechanics, and tax implications for a family office investing in listed company warrants under Indian tax law.

## Investment Structure

- **Warrants subscribed:** 10,000
- **Upfront premium paid:** ₹100/warrant (₹10,00,000 total, representing 25%)
- **Balance exercise price:** ₹300/warrant (₹30,00,000 total, representing 75%)
- **Exercise window:** 18 months from issuance
- **Market price on exercise date:** ₹500/share
- **Fair market value (FMV):** ₹500/share

## Capital Deployment Analysis

**Total investment to acquire shares:** ₹10,00,000 (upfront) + ₹30,00,000 (exercise) = ₹40,00,000 for 10,000 shares

**Effective cost basis:** ₹400 per share

## Intrinsic Value & Gain Calculation

**Unrealized gain on exercise:**

$(₹500 \text{ market price} - ₹400 \text{ effective cost}) \times 10,000 \text{ shares} = ₹100 \times 10,000 =$   
**₹10,00,000 intrinsic value**

### ☐ Tax Treatment on Exercise:

The ₹100/share differential (₹10,00,000 total) between FMV and total amount paid may be treated as income from other sources, though arm's length investor transactions often argue no immediate tax if FMV was disclosed at issuance. **Always consult a qualified Chartered Accountant** for your specific circumstances, as treatment varies based on investor classification and transaction structure.

## Post-Exercise Tax Position

- **Cost base for future capital gains:** ₹500/share (FMV on exercise date) = ₹50,00,000 total
- **Holding period:** Begins from exercise date for capital gains classification
- **If warrants lapse unexercised:** ₹10 lakh upfront premium claimable as capital loss.

# Taxation on Share Sale: XYZ Ltd Exit Scenarios

Continuing the XYZ Ltd case study: After exercising 10,000 warrants at ₹500/share FMV (cost base ₹50,00,000), the family office evaluates exit timing. Tax treatment depends critically on the holding period from the exercise/allotment date, with material differences between short-term and long-term capital gains under post-Budget 2024 rules.

## Scenario 1: Short-Term Sale

### Sale after 6 months at ₹600/share

Holding period: ≤12 months (listed shares)

Sale proceeds: ₹60,00,000

Cost base: ₹50,00,000 (FMV on exercise)

Capital gain: ₹10,00,000 (₹100/share)

Classification: Short-term capital gains (STCG)

**Tax: 20% flat = ₹2,00,000**

## Scenario 2: Long-Term Sale

### Sale after 18 months at ₹600/share

Holding period: >12 months (listed shares)

Sale proceeds: ₹60,00,000

Cost base: ₹50,00,000 (FMV on exercise)

Capital gain: ₹10,00,000 (₹100/share)

Classification: Long-term capital gains (LTCC)

**Tax: 12.5% (no exemption threshold) = ₹1,25,000**

## Scenario 3: Unlisted Shares

### Sale after 30 months at ₹600/share (if unlisted)

Holding period: >24 months (unlisted shares)

Sale proceeds: ₹60,00,000

Cost base: ₹50,00,000 (no indexation benefit)

Capital gain: ₹10,00,000

Classification: LTCC (unlisted)

**Tax: 12.5% without indexation = ₹1,25,000**

## Tax Optimization Strategies for Family Offices

### Timing Considerations

- **Hold beyond 12 months** to reduce tax rate from 20% to 12.5%—a 37.5% tax saving on gains
- **Strategic exercise timing:** Exercise warrants closer to anticipated exit events to minimize holding period tax exposure
- **Loss harvesting:** Offset gains with capital losses from other portfolio positions in the same financial year

# Strategic Implications for Family Offices

## Key Takeaways

- Warrants deliver leveraged exposure with defined downside, fitting multi-generational investment mandates
- Most valuable as "equity kickers" in private credit, PE transactions, and SPAC structures
- Require sophisticated modelling of dilution, cap table impacts, and tax efficiency
- Demand robust governance: valuation frameworks, exercise policies, and integrated portfolio monitoring
- Tax treatment varies significantly by holding period—strategic timing materially affects after-tax returns

## Implementation Considerations

Successful warrant strategies require clear investment policies, experienced legal counsel for documentation, sophisticated tax planning with qualified advisors, and integrated risk management across the broader portfolio. Family offices building in-house capabilities in these areas gain meaningful competitive advantages in sourcing and structuring attractive opportunities.

