How to Play a CannTrust Holdings (TSX:TRST) Recovery for $2 Per Share

Description

For reasons that have been covered extensively, **CannTrust Holdings** (TSX:TRST)(NYSE:CTST) is a shadow of its former self. As of writing, the stock is in the mid-$3 range, and with no clarity from management addressing the investigation, there are no catalysts for recovery back to the $5 level.

But chances are, if you're reading this, you are looking at playing a possible bounce in the share price, should we reach a satisfying conclusion to this ongoing saga. After all, **Aphria** exhibited similar optics after last year's short-selling controversy before recovering almost 150% off the lows.

That said, I believe buying the shares of this troubled company are far too risky even at these levels, and you should gain exposure via selling options — particularly put options.

Selling puts

For those with margin accounts (you can thank the CRA for not allowing put writing in registered accounts), there are quite a few ways to take advantage of Trust's elevated implied volatility. If you're unfamiliar with how options work, in a nutshell, implied volatility is a factor of option pricing that increases with market uncertainty (such as in the case of a massive sell-off). In other words, the more volatile a stock or an underlying asset is, the higher the implied volatility, and the higher the option's price compared to a similar option, all things equal.

Note, there are other factors that drive option prices as well as its implied volatility, but these are beyond the scope of this writing. Due to recent events, Trust's already high implied volatility has increased even more, thus making its options priced higher than they normally are; after all, neither you, me, nor the market know how things will resolve.

So, here's the strategy. Simply call up your broker or login to your brokerage account and "sell" the December $2.50 strike put on TRST on the U.S.-listed ticker. The reason we opt for the U.S. side is because there's a better inventory of options there as well as higher trading volume.

Here's how the strategy will play out. If by December 20, Trust is at US$2.50 or higher, your option will expire worthless to the buyer, and you will keep the premium you received for selling the option (as of last writing) of US$.90, or US$90, based on implied volatility of 128%. If by December 20, Trust is below US$2.50, you are obligated to buy 100 shares of Trust per contract sold from the buyer of your option at the strike of $2.50 per share.

But, because you received $90 per contract, this premium is netted against your cost basis, and you end up paying US$1.60 per Trust share (US$2.50 minus US$.90), or about CAD$2.08 when converted. I don't know about you, but I am willing to risk $2.08 per share in the event Trust goes completely to zero as opposed to its current $3.60 level.

Of course, the downside to this strategy is that you're limited to the $90 you received for the option, no matter how much Trust recovers. Luckily though, the options game is extremely complex, and there are other ways you can position yourself to increase your gains to the upside. However, that is a topic for another day, and if you have a margin account, I highly recommend you take advantage of the uncertainty and sell some puts against this very volatile name.

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