

# Beginners Corner Information

Lesson 5

Calculations For Stock And Option  
Selection

Covered Call Writing

# 3 Basic Formulas

- ROO (initial return on option) for ATM and OTM strikes
- ROO for ITM strikes
- Breakeven

# Calculating ATM AND OTM Strikes (Initial Returns)

- Option premiums are ALL time value or all profit
- Option premium x 100/ [price per share x 100]
- $\$1 \times 100 / [\$28 \times 100] = 3.6\%$
- OTM strikes will offer upside potential

# Calculating ITM Strikes (Initial Returns)

- ROO or profit = Option premium – intrinsic value (Buy @ \$32 and sell \$30 call @3; IV = \$2 and TV = \$1)
- Cost basis = Stock price – IV or the strike price (\$32 - \$2 = \$30)
- % ROO =  $\$100/\$3000 = 3.3\%$
- ITM strikes offer downside protection of the option profit

# Breakeven Of Total Position

Breakeven = Stock price – Option Premium

$$\$32 - \$3 = \$29$$

# Strike Price Selection

- OTM: ROO + Upside potential to strike
- ATM: Highest initial option return (ROO) but no upside potential or downside protection of ROO
- ITM: ROO + Downside protection of ROO

# Ellman Calculator- Single Tab Check Option Chain

Hi-Tech Pharmaceutical Co., Inc. (NASDAQ:  HITK) Optionable  
 Last: **22.34** Chg: **+1.48 (+7.07%)** Open: 20.68 Avg Vol: 367,139 Volume:  
 Bid: 22.35 Ask: 23.23 High: 22.41 Low: 20.68 VW%Chg:  
 After Hours Data Last: 22.36 Chg: **+0.02** %Chg: **+0.07%** Volume: 6,458

Option Tools: [Covered Calls Calculator](#) [Selling Pu](#)

View: All Months

Calls							Feb 10
Last	Intrinsic Value	Bid	Ask	Vol	Open Interest	Strike	
7.30	7.34	7.00	7.60	0	0	15.00	
4.85	4.84	4.70	5.00	0	22	17.50	
2.42	2.35	2.30	2.55	97	285	20.00	
0.50	0.00	0.45	0.55	55	402	22.50	
0.05	0.00	0.05	0.05	0	460	25.00	
0.05	0.00	0.05	0.05	3	726	30.00	
0.05	0.00	N/A	0.05	0	560	35.00	
0.10	0.00	N/A	0.10	0	0	40.00	

Spreads for Fri Feb 19 21:00:00 PST 2010 Options: [Bull Call Spreads](#) | [Bull F](#)

Calls							Mar 10
Last	Intrinsic Value	Bid	Ask	Vol	Open Interest	Strike	
7.45	7.34	7.30	7.60	0	0	15.00	
5.15	4.84	5.00	5.30	0	17	17.50	
3.25	2.35	3.10	3.40	1	115	20.00	
1.77	0.00	1.70	1.85	22	217	22.50	
0.88	0.00	0.80	0.95	8	129	25.00	
0.17	0.00	0.10	0.25	0	119	30.00	
0.10	0.00	0.05	0.15	0	20	35.00	

# Ellman Calculator- Single Tab Enter Information

THIS OPTION PAGE WILL ALLOW YOU TO COMPARE THE RETURNS ON UP TO FOUR DIFFERENT OPTIONS CHOICES FOR ONE STOCK PURCHASE.				
<b>1) ENTER THE STOCK NAME, SYMBOL AND PRICE PER SHARE</b>				
Stock name >>	Hi-Tech			
Stock symbol >>	HITK			
Stock share price >>	\$ 22.34			
<b>2) ENTER THE SYMBOL, STRIKE PRICE, EXPIRATION DATE AND OPTION PRICE PER SHARE</b>				
	Symbol	Strike Price	Exp Date	Price / share
Option choice #1 >>		20.00	03/19/10	3.10
Option choice #2 >>		22.50	03/19/10	1.70
Option choice #3 >>		25.00	03/19/10	0.80
Option choice #4 >>				



# Ellman Calculator- Single Tab Calculation Results

Option selected	HITK MAR 20.00	HITK MAR 22.50	HITK MAR 25.00
Today's date	02/16/10	02/16/10	02/16/10
Days to expiration	31	31	31
Cost for 100 shares of stock	\$ 2,234.00	\$ 2,234.00	\$ 2,234.00
Proceeds from one contract	\$ 310.00	\$ 170.00	\$ 80.00
IN / OUT OF THE MONEY	IN	OUT	OUT
INTRINSIC VALUE	\$ 2.34	\$ -	\$ -
UPSIDE AMOUNT	\$ -	\$ 16.00	\$ 266.00
UPSIDE POTENTIAL	0.0%	0.7%	11.9%
DOWNSIDE AMOUNT	\$ 234.00	\$ -	\$ -
DOWNSIDE PROTECTION	10.5%	0.0%	0.0%
<b>RETURN ON VARIOUS OUTCOMES</b>			
Proceeds from option sale	\$ 310.00	\$ 170.00	\$ 80.00
Amount of buy-down	\$ 234.00	\$ -	\$ -
Actual option profit	\$ 76.00	\$ 170.00	\$ 80.00
Option profit	\$ 76.00	\$ 170.00	\$ 80.00
Upside profit	\$ -	\$ 16.00	\$ 266.00
Total profit	\$ 76.00	\$ 186.00	\$ 346.00
Cost of shares	\$ 2,000.00	\$ 2,234.00	\$ 2,234.00
Return On Option (ROO)	3.8%	7.6%	3.6%
Return on Upside	0.0%	0.7%	11.9%
Total return	3.8%	8.3%	15.5%
Annualized return	44.7%	97.7%	182.5%

# Ellman Calculator- Multiple Tab Calculation Results

Stock Name or Symbol	Stock \$/sh	Option \$/sh	Strike \$	Expires	Intrinsic	Upside	ROO	Up Potential	Down Protect
nftx	\$ 75.00	\$ 4.70	\$ 75.00	05/21/10	\$ -	\$ -	6.3%	0.0%	0.0%
nftx	\$ 75.00	\$ 2.60	\$ 80.00	05/21/10	\$ -	\$ 5.00	3.5%	6.7%	0.0%
swks	\$15.49	\$ 1.15	\$ 15.00	05/21/10	\$ 0.49	\$ -	4.4%	0.0%	3.2%
dib	\$ 59.11	\$ 1.95	\$ 60.00	05/21/10	\$ -	\$ 0.89	3.3%	1.5%	0.0%
netl	\$ 29.40	\$ 1.65	\$ 30.00	05/21/10	\$ -	\$ 0.60	5.6%	2.0%	0.0%
ipxl	\$ 17.94	\$ 1.20	\$ 17.50	05/21/10	\$ 0.44	\$ -	4.3%	0.0%	2.5%
prgo	\$ 59.08	\$ 5.50	\$ 55.00	05/21/10	\$ 4.08	\$ -	2.6%	0.0%	6.9%
prgo	\$ 59.08	\$ 2.40	\$ 60.00	05/21/10	\$ -	\$ 0.92	4.1%	1.6%	0.0%
ctrp	\$ 40.29	\$ 4.00	\$ 38.00	05/21/10	\$ 2.29	\$ -	4.5%	0.0%	5.7%
ctrp	\$ 40.29	\$ 2.90	\$ 40.00	05/21/10	\$ 0.29	\$ -	6.5%	0.0%	0.7%
ctrp	\$ 40.29	\$ 2.00	\$ 42.00	05/21/10	\$ -	\$ 1.71	5.0%	4.2%	0.0%
urbn	\$ 37.84	\$ 2.75	\$ 36.00	05/21/10	\$ 1.84	\$ -	2.5%	0.0%	4.9%
urbn	\$ 37.84	\$ 1.60	\$ 38.00	05/21/10	\$ -	\$ 0.16	4.2%	0.4%	0.0%
urbn	\$ 37.84	\$ 0.80	\$ 40.00	05/21/10	\$ -	\$ 2.16	2.1%	5.7%	0.0%
shoo	\$ 48.96	\$ 1.95	\$ 50.00	05/21/10	\$ -	\$ 1.04	4.0%	2.1%	0.0%

## For A FREE Copy OF The Basic Ellman Calculator

- [alan@thebluecollarinvestor.com](mailto:alan@thebluecollarinvestor.com)
- "Basic Ellman Calculator" in header
- Include your name

# Summary

- Because ITM strikes have intrinsic value, the calculation formula is different than that of ATM and OTM strikes
- Breakeven relates to total cc position
- Downside protection relates to preservation of the time value of the option premium
- Each strike price category has its pros and cons
- In Lesson 6 we will discuss executing covered call trades