



ASX

AUSTRALIAN SECURITIES EXCHANGE

# Options – A Simple Guide

## Fact Sheet

### Introduction

There are two types of options traded on ASX, call options and put options.

*Call options* give the taker the right, but not the obligation, to buy the underlying shares.

*Put options* give the taker the right, but not the obligation, to sell the underlying shares.

	BUY (TAKER)	SELL (WRITER)
<b>Call Option</b>	Right to Buy	Obligation to Sell
<b>Put Option</b>	Right to Sell	Obligation to Buy

For example, a *WBC October 2000 Call option* gives the taker the right to buy 100 shares in Westpac Banking Corporation (WBC) for \$20.00 each, on or before the expiry date of the option in October. If exercised, the writer (seller) of this option must sell 100 WBC shares for \$20.00.

At the time of the option transaction, the option buyer pays the option seller a premium, which is the cost of the option.

Note that the taker of the option is not obligated to exercise the option. The taker can sell the option before it expires, or alternatively let the contract lapse at expiry, but will forego the option premium.

### Features of an Option

Option contracts have five main components. Four of these are set by ASX Clear Pty Limited, which is the subsidiary of ASX responsible for overseeing the clearing and operations of ASX options market.

These components are:

#### 1 The underlying securities

Options may be listed over the shares in a company listed on ASX, over a share price index.

You can trade options over most of Australia's largest companies, including News Corporation, Telstra, BHP Billiton and the major banks. Options are also available over the S&P/ASX 200 Index. To find out which securities have options listed over them; please refer to the ASX website [www.asx.com.au/options](http://www.asx.com.au/options)

#### 2 Contract size

One option contract covers 100 underlying securities, unless an adjustment to the terms of the contract has taken place. In the case of index options, the contract value is currently fixed at \$10 per index point. To calculate the value of the contract, multiply the index level by \$10. However you should check the ASX website or consult with your broker for the latest contract values.

#### 3 Exercise price

This is the price at which you buy or sell the underlying securities if you exercise your option.

There is a range of exercise prices to choose from for each options stock, for each expiry month. New exercise prices are listed as the underlying share price moves. You will usually be able to select from an exercise price close to the current market price of the underlying share, with at least two exercise prices also available above and below the current share price.

#### 4 Expiry date

This is the day on which all unexercised options in a particular series expire.

Each options stock has a range of different expiry months to choose from. ASX Clear generally lists series for a minimum period of nine to twelve months. As one series expires a new, more distant one is created. Many stocks also have a spot month available.

Share options usually expire on the Thursday before the last business Friday in the month. Index options usually expire on the third Thursday of the contract month.

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## Benefits of Options

Investors are attracted to options for several reasons:

### Earn income

You can earn income over and above dividends by writing call options against shares you own.

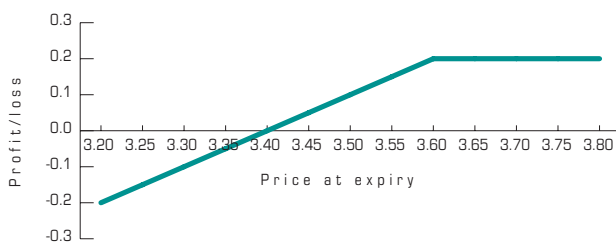
This is a very popular strategy with investors who expect the price of their shares to remain flat or fall slightly. Writing call options can generate extra income during such periods.

For example, assume you own 100 shares in Telstra (TLS), which in early February are trading at \$3.50. You believe that over the next couple of months, the share price is likely to stay around current levels.

You write a March expiry 360 Call options for a premium of \$0.10.

Writing the March 360 Calls means that you accept the obligation to sell your Telstra shares for \$3.60, if the options are exercised. For this you receive the premium of \$0.10 per share (\$10 for the contracts).

The following graph illustrates the profit or loss you would make at expiry:



If at expiry, the share price is below \$3.60, the options should expire worthless. Your TLS shares may have fallen in value, but you have earned \$10 in extra income for selling the calls. Because of the extra income, in this example the share price can fall to \$3.40 before you make a loss on the strategy overall.

If, however, the share price is above \$3.60, the options will be exercised and you will have to sell your shares. Effectively you have sold your shares for \$3.70 (the exercise price of \$3.60 plus the option premium of \$0.10).

Brokerage and transaction fees will also apply when trading and exercising option contracts.

Covered calls can also be written against stock you have bought on margin. Please refer to the ASX website for more details.

## Protect the value of your shares

Put options allow you to protect your shares against a fall in value. Buying a put option locks in the sale price of your shares for the life of the option, no matter how low the share price may go.

Without using put options, in a market downturn you can only watch your shares fall in value, or sell them.

For example, if in early June you believe the share price of News Corporation (NWS) is going to fall from current levels of \$14.50, you could buy an NWS July 1450 Put option, say for \$1.00. This option gives you the right to sell your NWS shares at the exercise price of approximately \$14.50 any time up until the option's expiry.

A great advantage of this strategy is that if the share price should rise, you are not obligated to sell your shares. Your shares will benefit from the price rise, and all you have lost is the put option premium.

## Speculate

You can use options to profit from a movement in the underlying shares without having to trade the shares themselves.

Options give you exposure to movements in the share price for a fraction of the cost of purchasing the shares themselves. Because of the small initial outlay, you can gain leveraged exposure to share price moves.

With an increase in the price of the underlying shares, the percentage return on the purchase of a call option may be greater than on the purchase of the underlying stock. Similarly, if the price of the underlying shares fall, percentage return on the purchase of a put option may be greater than the percentage change in value of the shares.

For example, assume it is mid-January and you believe the share price of Newcrest Mining Limited (NCM) will rise over the next two months. The following table compares the returns from buying NCM shares at \$31.00 with the returns from buying a NCM March 3100 Call option at \$3.00, assuming that the NCM share price has risen to \$40.00 by the option's expiry in March.

	SHARES	MARCH 3100 CALL
10 January	\$31.00	\$3.00
30 March	\$41.00	\$9.00
Profit	\$10.00	\$6.00
Percentage return	32%	200%

In this example the percentage return from buying the call options is significantly greater than the return from buying the shares.

However, just as leverage provides the potential to make high percentage returns, it also involves the risk of making large percentage losses.

### Time to decide

There may be times when you are unsure whether you want to go ahead with the purchase or sale of shares. Buying an option enables you to defer your decision until the option's expiry.

When you buy a call option you lock in the purchase price for the shares. You then have until the expiry day to decide whether or not to exercise the option and buy the shares. Similarly, by taking a put option you lock in a selling price, and give yourself time to decide whether or not to proceed with the sale of the shares.

In both cases, the most you can lose is the premium you have paid for the option in the first place.

### Index Options

Index options are similar in many ways to share options. These are also premium upfront options, similar to share options. The difference is that they are over the S&P/ASX 200 Index, instead of over shares in a single company.

This means that you can effectively trade the top 200 stocks in one transaction. If you hold a view on how the market as a whole will perform, buying or selling Index options is a simple way to trade your view. Index options provide you with diversified exposure, without having to invest directly in all the stocks in the index.

### How Options are traded

Options are traded on the ASX TradeMatch® system, which is an automated trading system linking brokers from all round Australia. You place an order through your broker, just as you would with shares.

Opening and closing option positions are facilitated by the Market Makers operating in ASX options market. Market Makers play an important role in the options market.

Their obligations to provide quotes are not unqualified and your ability to trade out of a strategy may depend on if you are able to obtain a quote from a Market Maker. The scope of the obligation of Market Makers is described in page 30 of 'Understanding Options Trading'.

This requirement is to promote liquidity in the market, so that you are more easily able to trade into and out of option positions.

In order to trade options, clients will have to open an options account with a broker, and sign a client agreement form and a risk disclosure statement. A broker will provide you with these documents.

### Additional information

Consult your advisor, visit the ASX website [www.asx.com.au/options](http://www.asx.com.au/options) or contact ASX customer service on 131 279 for further information.

Why not take advantage of an ASX options free online course [www.asx.com.au/resources/education/classes/online.htm](http://www.asx.com.au/resources/education/classes/online.htm)

Or download a copy of ASX 'Understanding Options Trading' booklet from [www.asx.com.au/resources/publications/booklets.htm](http://www.asx.com.au/resources/publications/booklets.htm)

Like any investment, options have risks that you need to understand before investing. Specific risks include market risk. You should obtain independent advice from a professional advisor prior to making any final decision.

### Face to Face Classes

From time to time ASX holds free education seminars on options. To be kept informed of upcoming sessions please register your interest at [www.asx.com.au/keepmeposted](http://www.asx.com.au/keepmeposted)

### Online Classes

Online options classes include interactive exercises that will aid your learning and a quiz at the end of each section to show your progress.

### Website

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