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## Using Put Options to Buy Stock at a Discount

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You can use put options to purchase stock at a price lower than the market price.

Let's use Oracle Inc. as an example.

Date: November 20, 2000

ORCL closing price:  $24 \frac{3}{4}$

ORCL Put option<sup>1</sup> closing price:  $4 \frac{5}{8}$

Selling 2 contracts nets  $4 \frac{5}{8} * 200 = \$925$ . (one contract = 100 shares).

At this point we have \$925 in cash in our account. However, we also have the obligation to purchase 200 shares of ORCL at \$25 anytime between now and March 2001.

What can happen between now and March 2001 is really only two things:

- 1) ORCL closes equal to or above \$25 in March, 2001 (at expiration of the option)
- 2) ORCL closes below \$25 in March 2001 (at expiration of the option)

For case 1 the option expires worthless and you have a short-term profit of \$925.

For case 2, let's say ORCL is selling for \$22 at expiration, then you would have to pay \$25 per share for 200 shares = \$5,000. However you deduct the option proceeds from the cost therefore the net cost is  $\$5,000 - \$925 = 4,075$ . Your cost per share is:  $\$20$ . In case 2, even though ORCL was selling for  $24 \frac{3}{4}$  originally, we actually purchased it for  $\$20$  and we held onto \$925 and earned interest while we waited for expiration.

Of course ORCL could be selling for some other value other than \$22 but the logic is the same and we would never have a net price per share over  $\$20$ . You can also get "assigned" which means you must buy ORCL at \$25 before expiration.

The real downside is when ORCL sells for a *lot* less than  $\$20$ . You are still obligated to pay \$25 per share (minus the option proceeds).

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<sup>1</sup> March 2001 \$25 ORQOE

### **Always a Win?**

It's difficult to imagine that any investment is always positive but selling put options comes close. Consider the possible scenarios after selling a put option on a stock that you are willing to buy at the current market price:

1. The stock goes nowhere - you profit from the option premium and can still buy the stock at a similar price. **BIG WIN**
2. The stock goes way down – you buy the stock at a “discount” from the original price where the discount is the original price minus the put option premium. I suggest that this is a win also since you were willing to pay the original price. Also you get the option premium up front and you postponed paying for the stock until the option was exercised. **WIN**
3. The stock goes way up - you keep the premium but you have missed out on the run up. **PARTIAL WIN**

Should you use this strategy to buy all your stocks? I don't think so because the only stocks you'll ever own are the ones that went down. You'll partially miss out on all the ones that went up a lot. OF course some of the stocks you bought will eventually become profitable and some of the stocks you missed would go on to become losers. I don't know what the performance would be of such a portfolio - try it out and let me know!

*Disclaimer: options are complex and highly risky and should be undertaken only by those very familiar with techniques of options trading. You can lose lots of money very quickly with options. Some option positions have the potential for unlimited losses.*