

Premium

Premium is the total amount of money (price) you pay for an option. So, if the Microsoft (MSFT) May 65 calls cost you \$1.50 then the \$1.50 is the amount of the premium of the option.

The total price of an option (premium) consists of two components. Those two components are intrinsic value and extrinsic value.

Please view charts below for **option price (premium)** examples.

<i>MSFT CALLS</i>				
<i>65.00</i>				<i>Stock = \$</i>
<i>Strike Price</i>	<i>Option Price</i>	<i>Status</i>	<i>Intrinsic Value</i>	<i>Extrinsic Value</i>
50	15.10	ITM	15.00	.10
55	10.30	ITM	10.00	.30
60	5.70	ITM	5.00	.70
65	1.50	ATM	0	1.50
70	.75	OTM	0	.75
75	.35	OTM	0	.35
80	.15	OTM	0	.15

<i>MSFT PUTS</i>				
<i>\$65.00</i>				<i>Stock =</i>
<i>Strike Price</i>	<i>Option Price</i>	<i>Status</i>	<i>Intrinsic Value</i>	<i>Extrinsic Value</i>
50	.10	OTM	0	.10
55	.30	OTM	0	.30
60	.70	OTM	0	.70
65	1.50	ATM	0	1.50
70	5.70	ITM	5.00	.70
75	10.30	ITM	10.00	.30
80	15.10	ITM	15.00	.10

Intrinsic value, also called **parity**, is the amount by which an option is in the money. In the case of a call, the intrinsic value is equal to the present stock price minus the strike price. In the case of a put, the intrinsic value is equal to the strike price minus the present stock price. Only in-the-money options have intrinsic value. Out-of-the-money options have no intrinsic value.

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For example, with MSFT trading at \$65.00, the MSFT January 60 calls will have \$5.00 of intrinsic value. If the MSFT January 60 calls were trading at \$5.70, then \$5.00 of that premium would be intrinsic value.

At the same time, the MSFT January 70 put will also have \$5.00 of intrinsic value. So, if the MSFT January 70 puts were trading for \$5.70, then \$5.00 of that premium would be intrinsic value.

Please view charts below for [intrinsic value](#) examples.

<i>MSFT CALLS</i>				<i>Stock = \$</i>
<i>65.00</i>				
Strike Price	Option Price	Status	<i>Intrinsic Value</i>	Extrinsic Value
50	15.10	ITM	15.00	.10
55	10.30	ITM	10.00	.30
60	5.70	ITM	5.00	.70
65	1.50	ATM	0	1.50
70	.75	OTM	0	.75
75	.35	OTM	0	.35
80	.15	OTM	0	.15

<i>MSFT PUTS</i>				<i>Stock =</i>
<i>\$65.00</i>				
Strike Price	Option Price	Status	<i>Intrinsic Value</i>	Extrinsic Value
50	.10	OTM	0	.10
55	.30	OTM	0	.30
60	.70	OTM	0	.70
65	1.50	ATM	0	1.50
70	5.70	ITM	5.00	.70
75	10.30	ITM	10.00	.30
80	15.10	ITM	15.00	.10

[Extrinsic value](#) is defined as the price of an option less its intrinsic value. In the case of out-of-the-money options, the option's entire price consists only of extrinsic value. Extrinsic value is made up of several components, with the largest being volatility.

In the examples above, if the MSFT January 60 calls were trading at \$5.70 and \$5.00 of that was intrinsic value, then the remainder (\$.70) is extrinsic value. The same also holds true for the January 70 puts. If they were



trading at \$5.70 and \$5.00 of that was intrinsic value, then the rest (\$.70) is extrinsic value.

Please view charts below for [extrinsic value](#) examples.

MSFT CALLS				Stock = \$
Strike Price	Option Price	Status	Intrinsic Value	<i>Extrinsic Value</i>
50	15.10	ITM	15.00	.10
55	10.30	ITM	10.00	.30
60	5.70	ITM	5.00	.70
65	1.50	ATM	0	1.50
70	.75	OTM	0	.75
75	.35	OTM	0	.35
80	.15	OTM	0	.15

MSFT PUTS				Stock = \$
Strike Price	Option Price	Status	Intrinsic Value	<i>Extrinsic Value</i>
50	.10	OTM	0	.10
55	.30	OTM	0	.30
60	.70	OTM	0	.70
65	1.50	ATM	0	1.50
70	5.70	ITM	5.00	.70
75	10.30	ITM	10.00	.30
80	15.10	ITM	15.00	.10

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