

STOCK PATHSHALA

Covered Call Strategy PDF

A practical guide to earning premium on shares you already own: payoff, formulas, India notes and a pre-trade checklist.

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Educational material. Not investment advice. All numbers are hypothetical.

What is a covered call?

Own the shares. Sell a call against them. Collect the premium today.

A **covered call** means you hold a stock (or a long position in it) and sell a call option on the same stock. The call is "covered" because your shares can be delivered if the buyer exercises.

In return for selling the call, you receive a **premium**. That premium is yours to keep whatever happens next.

The trade-off is simple: you give up gains above the strike price in exchange for income now and a small cushion on the downside.

How it works

Think of it as renting out your upside. The call buyer pays you for the right to buy your shares at the strike. If the stock stays below the strike, the option expires worthless and you keep the premium and the shares.

If the stock closes above the strike at expiry, the shares are sold at the strike. Your profit is capped, but you still keep the premium.

When traders use it

These situations are where a covered call is commonly considered:

- You expect the stock to move sideways or rise only slowly.
- You want regular income from shares you plan to hold anyway.
- You are happy to sell at the strike price if the stock gets there.
- You want a small buffer against a mild fall.

Key formulas

Use these for any covered call. All figures are per share; multiply by the lot size for the rupee amount.

Max profit = (Strike – Purchase price) + Premium received

Break-even = Purchase price – Premium received

Max loss = Purchase price – Premium received (if the stock goes to zero)

Upside is capped at the strike. Downside is only cushioned by the premium, not removed.

Example inputs used in this guide

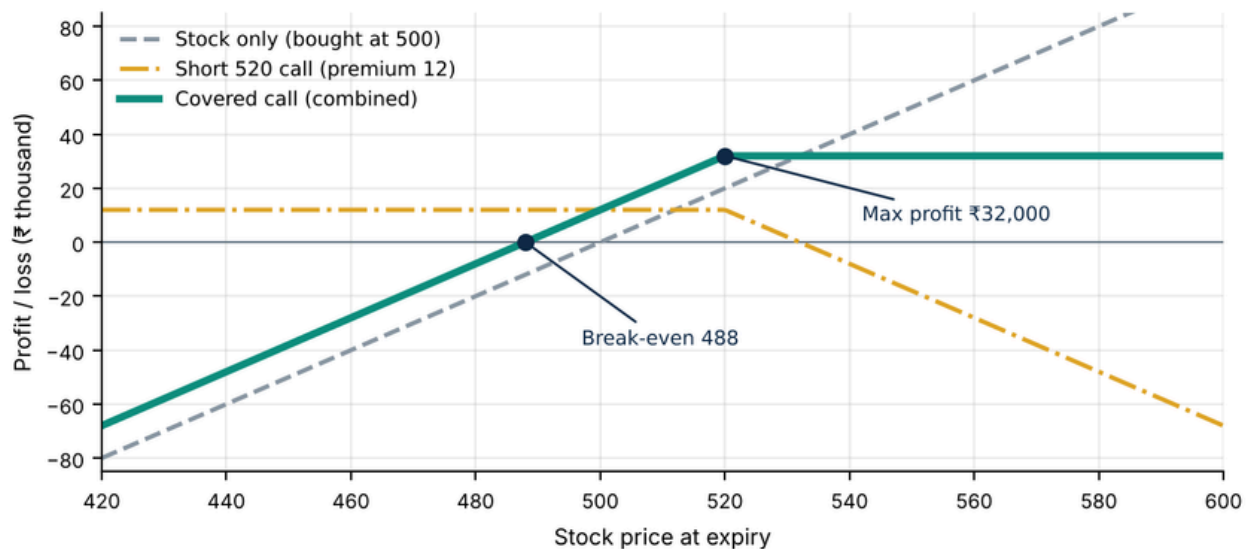
Hypothetical stock bought at ₹500. You sell a ₹520 call for a premium of ₹12. Lot size 1,000 shares (illustrative; real lot sizes differ, so verify on NSE).

Measure	Per share	Per lot (1,000)
Max profit	₹32 (20 + 12)	₹32,000
Break-even	₹488 (500 – 12)	–
Max loss (stock to zero)	₹488	₹4,88,000

Payoff diagram

How the stock, the short call and the combined position behave at expiry.

The chart uses the hypothetical numbers above. The green line is your covered call. It rises with the stock, then flattens at the strike.



Read the chart

- Below ₹488 you lose money, though the loss is ₹12 per share smaller than owning the stock alone.
- At or above ₹520 your profit stays at ₹32,000, however high the stock goes.
- Between 488 and 520 you profit, with the best result at the strike.

Worked example: scenarios at expiry

Profit or loss for one lot (1,000 shares) at different closing prices. Hypothetical figures, before charges and taxes.

Stock at expiry	Stock P&L	Short call P&L	Covered call P&L
₹440	–₹60,000	₹12,000	–₹48,000
₹470	–₹30,000	₹12,000	₹18,000
₹488	–₹12,000	₹12,000	₹0
₹500	₹0	₹12,000	₹12,000
₹520	₹20,000	₹12,000	₹32,000
₹540	₹40,000	₹8,000	₹32,000
₹580	₹80,000	₹48,000	₹32,000

Highlighted rows: break-even (488) and the strike (520). Above 520 the extra gain on the stock is cancelled by the loss on the short call.

Step-by-step checklist

Work through four stages. Tick each item before moving on.

1. Before you sell the call

- ☐ Confirm you own the shares or hold a long position, and know your purchase price.
- ☐ Check the current lot size on NSE and make sure your quantity matches it.
- ☐ Decide your view: sideways or mildly bullish, and happy to sell at the strike.
- ☐ Check the margin the broker needs for the short call. Your demat shares do not cut it automatically.
- ☐ Look at upcoming events: results, dividends, policy dates.

2. At entry

- ☐ Pick a strike you would be comfortable selling the shares at.
- ☐ Pick an expiry that suits your goal; shorter expiries lose time value faster.
- ☐ Compare the premium with the cap on your upside. Is it worth it?
- ☐ Use a limit order and check the bid-ask spread.
- ☐ Note your break-even and max profit in writing.

3. During the trade

- ☐ Track the stock against your strike and your break-even.
- ☐ Watch margin, especially if the price rises or expiry gets close.
- ☐ Decide in advance what you will do if the stock falls sharply.
- ☐ Decide in advance what you will do if it rallies through the strike.
- ☐ Avoid adding more calls just because premium looks attractive.

4. Near expiry

- ☐ If the call is in the money on a stock option, remember delivery is expected. Keep shares unpledged and available.
- ☐ Choose: let it expire, buy back the call, or roll to a later date.
- ☐ Check extra margin charged in the final week.
- ☐ Review the trade: what worked, what did not.

India notes and risks

Rule that matters to Indian traders. Verify current details on NSE and with your broker.

India-specific points

- **Stock options are physically settled.** An in-the-money stock call at expiry leads to delivery of shares at the strike.
- **Index options are cash-settled.** Nifty and Bank Nifty options settle in cash, with no share delivery.
- **Demat shares do not auto-cut margin.** Shares sit in the equity segment; margin on the short call is computed in derivatives.
- **Pledging.** Pledged shares count as collateral after a haircut, and brokers usually need part of the margin in cash. Pledged shares cannot be delivered until unpledged.
- **Margin can rise** near expiry and when the price rises. Brokers can charge more than the exchange minimum.
- **Lot size changes.** NSE revises lot sizes from time to time. Always check the current lot size on NSE before trading.
- **Tax.** F&O results are generally treated as business income. Confirm treatment with a CA.

Risks to respect

A covered call is often called conservative. It still carries real risk.

- **Stock falls.** The premium is a small cushion. A big fall means a big loss on the shares.
- **Capped upside.** If the stock jumps, you miss most of the gain.
- **Assignment.** On stock options you may have to deliver shares and lose your position.
- **Gap risk.** Overnight news can move the stock beyond your strike or break-even.
- **Concentration.** Holding one stock and selling calls on it does not diversify you.
- **Costs.** Brokerage, STT and other charges reduce the net premium.

Quick comparison and glossary

Two related strategies, then ten terms worth knowing.

Related strategies

Strategy	In one line
Covered call	Long stock + short call: earn premium, cap the upside, small cushion on the downside.
Protective put	Long stock + long put: pay a premium for a floor on losses, upside stays open.
Synthetic covered call	Long stock + short call has the same payoff shape as a short put.

Glossary

Term	Meaning
Premium	The price the option buyer pays the seller.
Strike price	The price at which the option can be exercised.
Expiry	The date the option contract ends.
Lot size	Number of shares in one contract. Check NSE.
In the money (ITM)	A call whose strike is below the stock price.
Out of the money (OTM)	A call whose strike is above the stock price.
Assignment	The seller is required to fulfil the contract.
Physical settlement	Settlement by delivery of shares, used for stock options.
Break-even	The price at which the trade neither gains nor loses.
Rolling	Closing the current option and selling a later one.

Pre-trade checklist worksheet

Fill this in before every covered call. Print it or copy it into your journal.

Item	Your notes
Stock and date	
Purchase price (per share)	
Lot size (checked on NSE)	
Number of lots	
Strike price chosen	
Expiry date	
Premium per share	
Max profit = (Strike – Purchase) + Premium	
Break-even = Purchase – Premium	
Max loss = Purchase – Premium	
Margin needed (broker)	
Shares pledged? Available for delivery?	
Events before expiry	
Exit plan if stock falls	
Exit plan if stock rallies past strike	

☐ I understand I may have to deliver shares. ☐ I accept the maximum loss shown above.

Where to go next

Practice the numbers, then build the habit.

A covered call looks simple on paper. The skill is in picking strikes, managing margin and staying calm when the stock moves.

Run the worksheet on a few hypothetical trades before you risk real money.

If you would like to learn this with a trader beside you, Stock Pathshala runs **live classes** on option trading, with a plan set for each learner. Details are at **stockpathshala.com/option-trading-classes/**.

Disclaimer

This PDF is for education only and is not investment advice. All examples are hypothetical. No profit is guaranteed. Options carry risk, and you can lose money, including more than the premium received. Rules, lot sizes and margins change, so verify current details on NSE and with your broker. Confirm tax treatment with a Chartered Accountant (CA).