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Trading Earnings Reports

Russell Rhoads
Director – The Options Institute



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Planning a Trade

Outline

- **Earnings Reports**
- **Conference Call**
- **Market Impact**
- **Trading Examples**
- **Summary / Q&A / Contact**

Earnings Reports

What They Are

- **Public companies in the United States are required to report financial results on a quarterly basis**
- **The majority of companies operate where results are announced in January, April, July, and October each year**
- **Earnings ‘season’ usually begins the first full week of each of these months**

Earnings Reports

What They Are

- **The stock prices for many companies often react dramatically based on the content of their results**
- **In 2000 Regulation FD was established to address the selective disclosure of information by publicly traded companies**
- **After the implementation of Regulation FD the impact of earnings announcements was more dramatic with respect to stock price changes**

Earnings Reports

The Event

- **Press release issued usually outside of market hours**
- **Business networks report highlights as quickly as possible**
- **Analysts dig into financials looking for what they consider important pieces of information**
- **After a short period of time management will host a conference call to discuss results and answer questions**

Although this is all occurring outside of market hours there is stock trading going on

Earnings Reports

Important Information

- **Net Income and earnings per share**
- **Revenues**
- **Segment or specific product sales**
- **Profit margins**
- **Any potential outlook or forward looking statements**

Earnings Reports

Earnings Per Share

- Usually the first piece of information analysts look for when the news is released
- Defined as profits after paying dividends on preferred stocks divided by the number of outstanding shares
- This result can benefit from higher revenues or lower costs or a combination of both
- A change in the number of shares outstanding would have an impact on this result

Earnings Reports

Revenues

- **This is a report of the total sales produced by a company over the previous quarter**
- **The revenue result may often carry more weight than the earnings number**
- **Sales are more difficult for a company to ‘manage’ than earnings**
- **Revenue trends often lead a decline in profits**

Earnings Reports

Segmented Sales

- ▶ **Many companies have products that are leading producers of profit and sales growth**
- ▶ **Growth in new geographic markets could influence the outlook for a company**
- ▶ **Market acceptance of new products may often be important for continued profit growth**
- ▶ **Analysts will focus on new product or high margin product sales trends**

Earnings Reports

Profit Margins

- **The difference between revenues and expenses will determine profit margins**
- **This is another key factor that analysts will focus on to determine trends in business conditions**
- **Margins may be impacted by higher costs or lower sales**
- **Either factor could indicate that an industry is becoming more competitive**

Conference Call

Format

- **After the initial press release management often will hold a conference call with all interested parties**
- **In this call they will expand on what was said in the press release**
- **Management will also field questions from analysts and investors**
- **The nature of this question and answer period can give good insight into how the investment community is interpreting the new information**

Market Impact

Stock Price Reaction

- All stocks are unique
- They have their own trading characteristics and often react differently to earnings reports
- There is a risk of a large stock price changes the first trading day after earnings reports
- Option markets often adjust in anticipation of an earnings report and then adjust again after the earnings news has been made public

Market Impact

Historical Price Reactions

Ticker	Max	Min	Abs Avg	Last Q
AXP	5.12%	-3.63%	2.17%	-0.87%
BAC	10.12%	-4.92%	3.25%	-1.90%
C	5.50%	-8.21%	3.00%	3.02%
EBAY	13.24%	-6.73%	4.99%	0.65%
INTC	9.27%	-6.31%	3.17%	9.27%
JNJ	2.12%	-1.99%	0.98%	-1.99%
KMI	2.36%	-2.51%	1.04%	-0.27%
NFLX	42.22%	-34.90%	18.01%	-4.62%
URI	15.49%	-13.85%	6.87%	1.69%
WFC	3.23%	-8.44%	1.95%	-0.62%

Data Source: Bloomberg

Market Impact

Implied Volatility Forecast

October 25, 2012 – FB @ 51.95 – Reports on October 29, 2012

Exp. Friday	Days	ATM IV
Nov 1	7	123.80%
Nov 8	14	93.40%
Nov 15	21	78.90%
Nov 22	28	72.40%
Nov 29	36	67.40%
Dec 21	57	58.80%
Jan 18	85	54.20%

Data Source: Bloomberg

Market Impact

Implied Volatility Forecast

October 25, 2012 – TSLA @ 169.66 – Reports November 5, 2012

Exp. Friday	Days	ATM IV
Nov 1	7	53.90%
Nov 8	14	95.50%
Nov 15	21	84.50%
Nov 22	28	80.30%
Nov 29	36	74.30%
Dec 21	57	67.30%
Jan 18	85	63.30%

Data Source: Bloomberg

Market Impact

Initial Reaction

- **The initial reaction occurs during a time period where the primary stock markets are closed**
- **This is known as pre or post market trading**
- **Reaction may very volatile due to lack of liquidity and uninformed trading**
- **Due to low liquidity there may be some ‘gaming’ by traders**
- **This trading is often occurring without a full assessment of the news release**
- **It is also occurring before management has a chance to address the investing public on their earnings call**

Market Impact

Secondary Reaction

- **Occurs over the course of the first trading day after the news release**
- **More informed trading occurs at this time**
- **Analyst opinions and possible ratings changes will impact this trading**
- **Traders that are 'playing earnings' will exit their trades shortly after the news has been released**

Market Impact

Reaction Disconnect

- **The relationship between earnings and the stock price reaction is not so simple**
- **There is a esoteric thing known as ‘quality of earnings’ where analysts dissect earnings**
- **Earnings may appear strong on the surface but revenues and profit margins may actually be weak**
- **Outlook and management’s performance on the earnings conference call is important to many market participants**

TSLA Earnings

Short Strangle

- TSLA reported earnings after the close Wednesday August 5th
- Just before the close with the stock trading at 270.13 there was a short strangle executed in TSLA options

Three year summary of TSLA earnings reactions

Max	Min	Abs Avg.	Last Q
24.40%	-14.51%	9.15%	2.76%

Sell 1 TSLA Aug 7th 230 Put at 0.89

Sell 1 TSLA Aug 7th 300 Call at 1.83

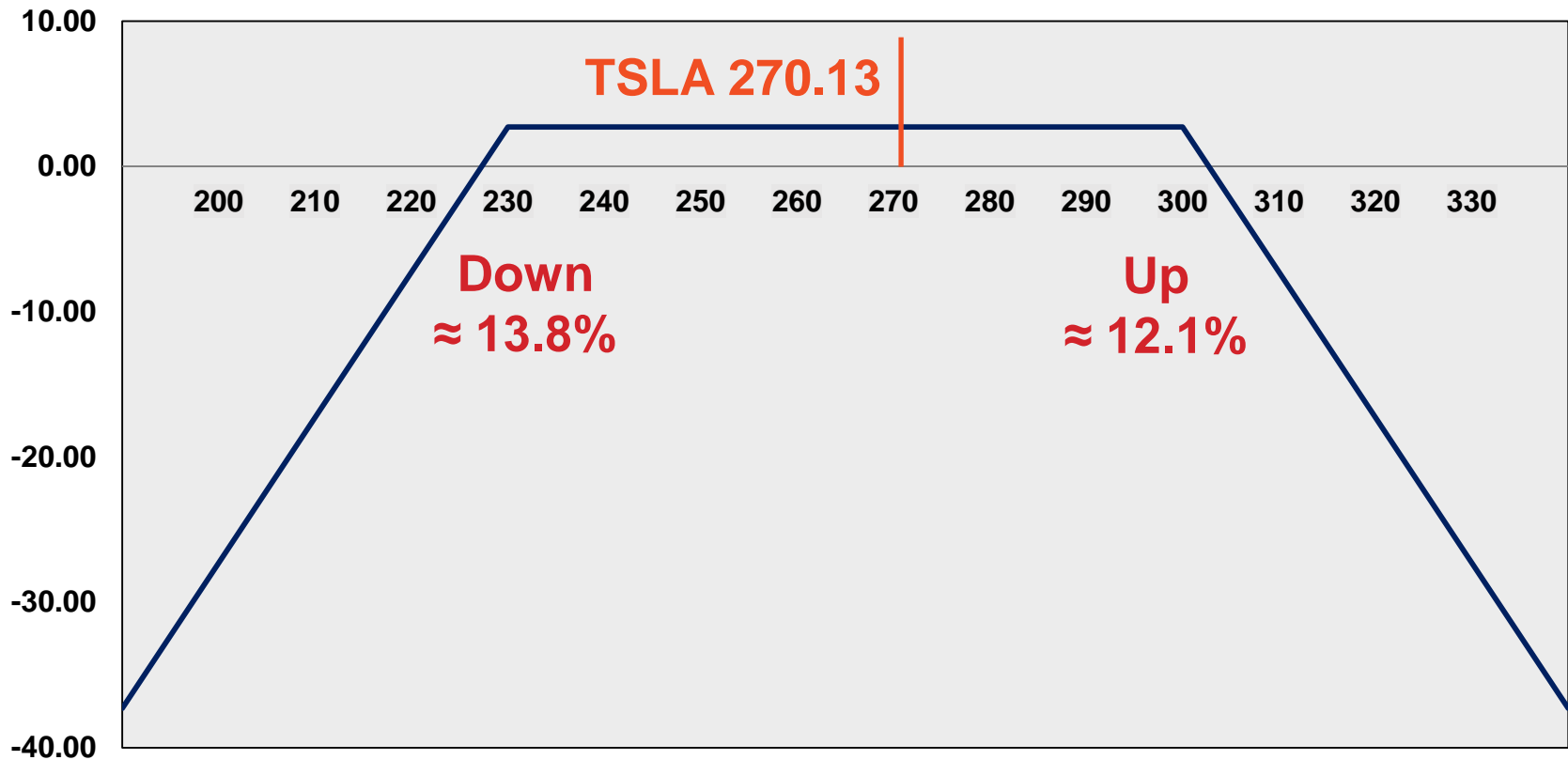
Net Credit = 2.72

Data Source: Bloomberg

TSLA Earnings

Short Strangle

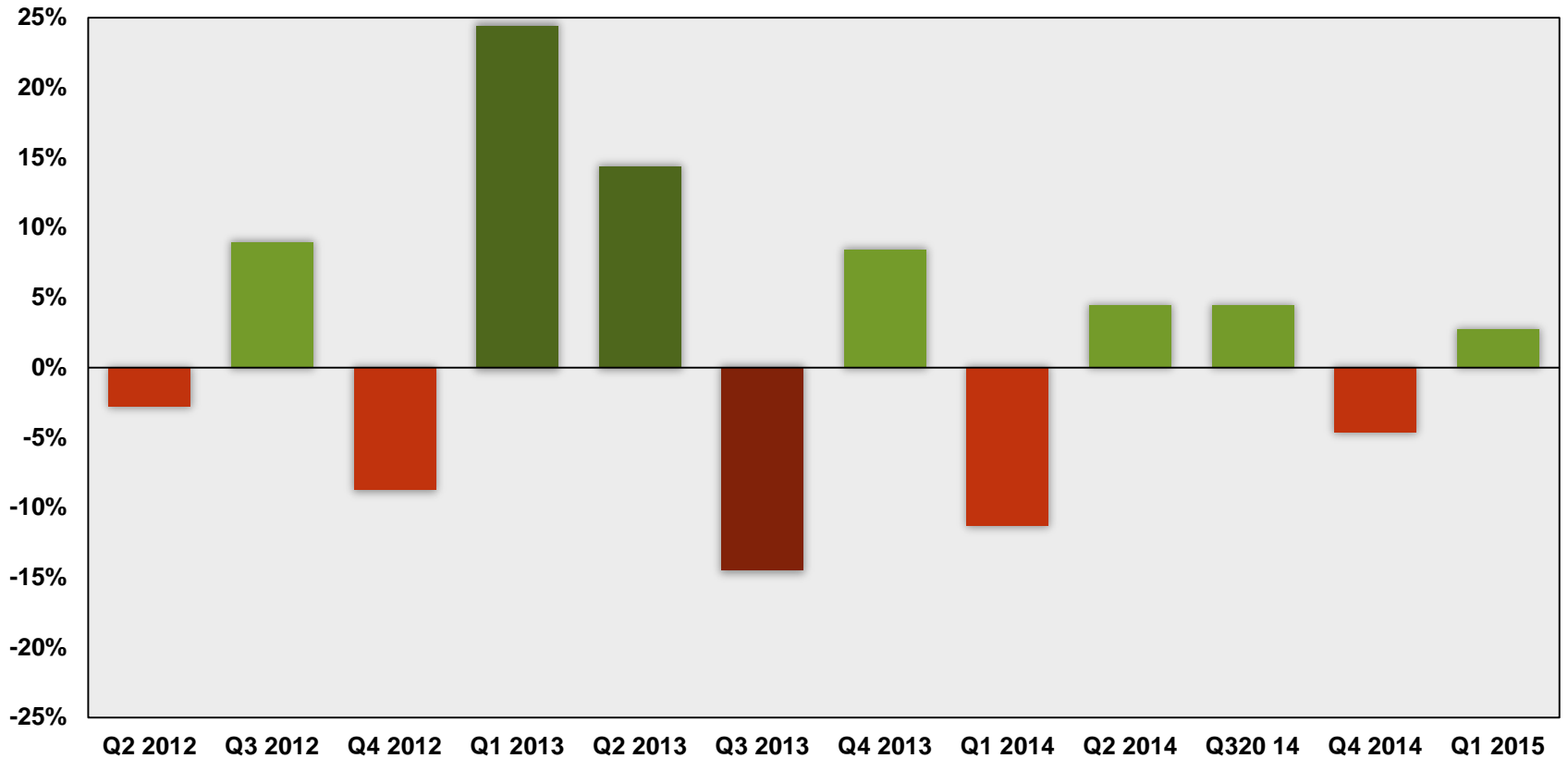
Short TSLA Aug 7th 230 Put / Short TSLA Aug 7th 300 Call



TSLA Earnings

Short Strangle

3 Year Earnings History Breakdown



Data Source: Bloomberg

TSLA Earnings

Bear Call Spread

- TSLA reported earnings after the close Wednesday August 5th
- About 20 minutes before the close with the stock trading at 270.08 there was a bear call spread executed in TSLA options

Three year summary of TSLA earnings reactions

Max	Min	Abs Avg.	Last Q
24.40%	-14.51%	9.15%	2.76%

Sell 1 TSLA Aug 7th 280 Call at 6.83

Buy 1 TSLA Aug 7th 305 Call at 1.28

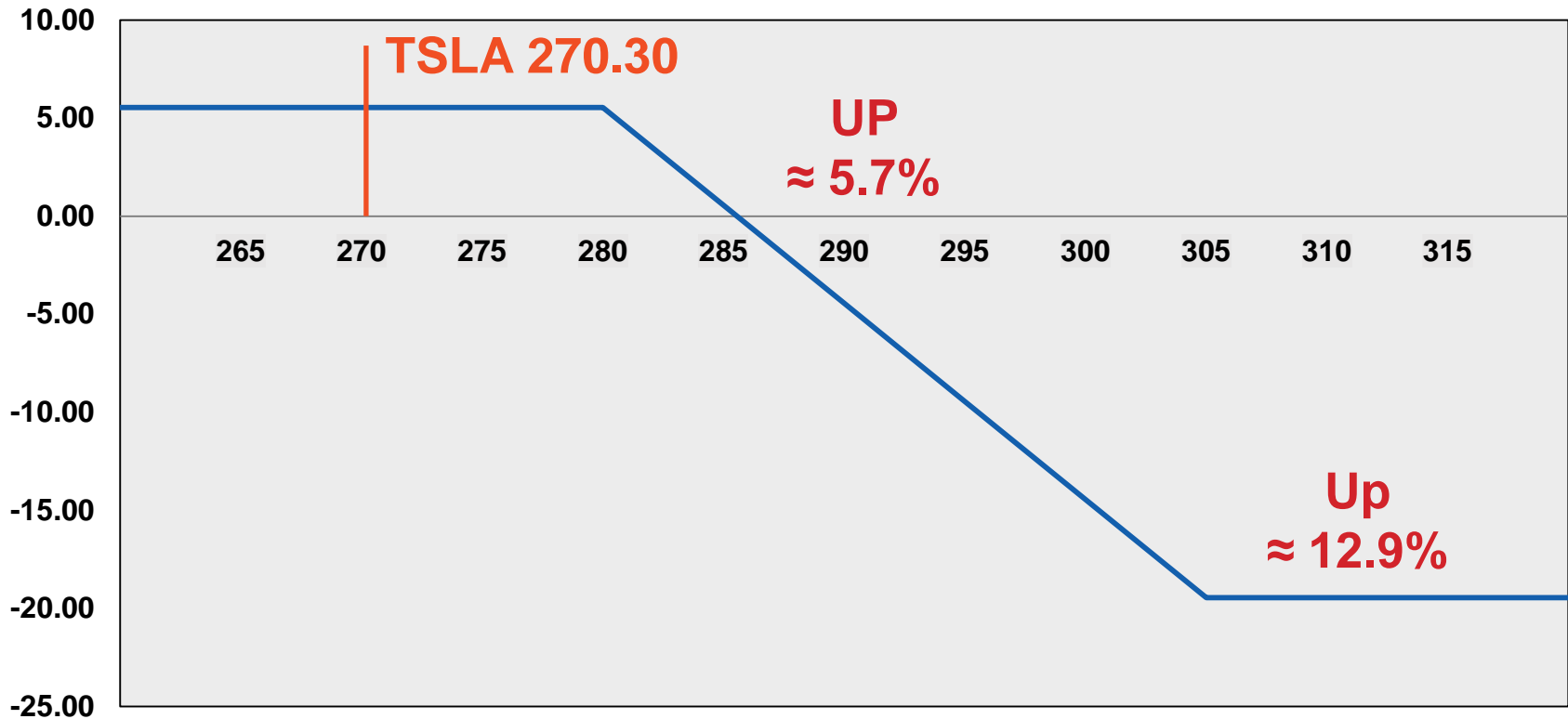
Net Credit = 5.55

Data Source: Bloomberg

TSLA Earnings

Bear Call Spread

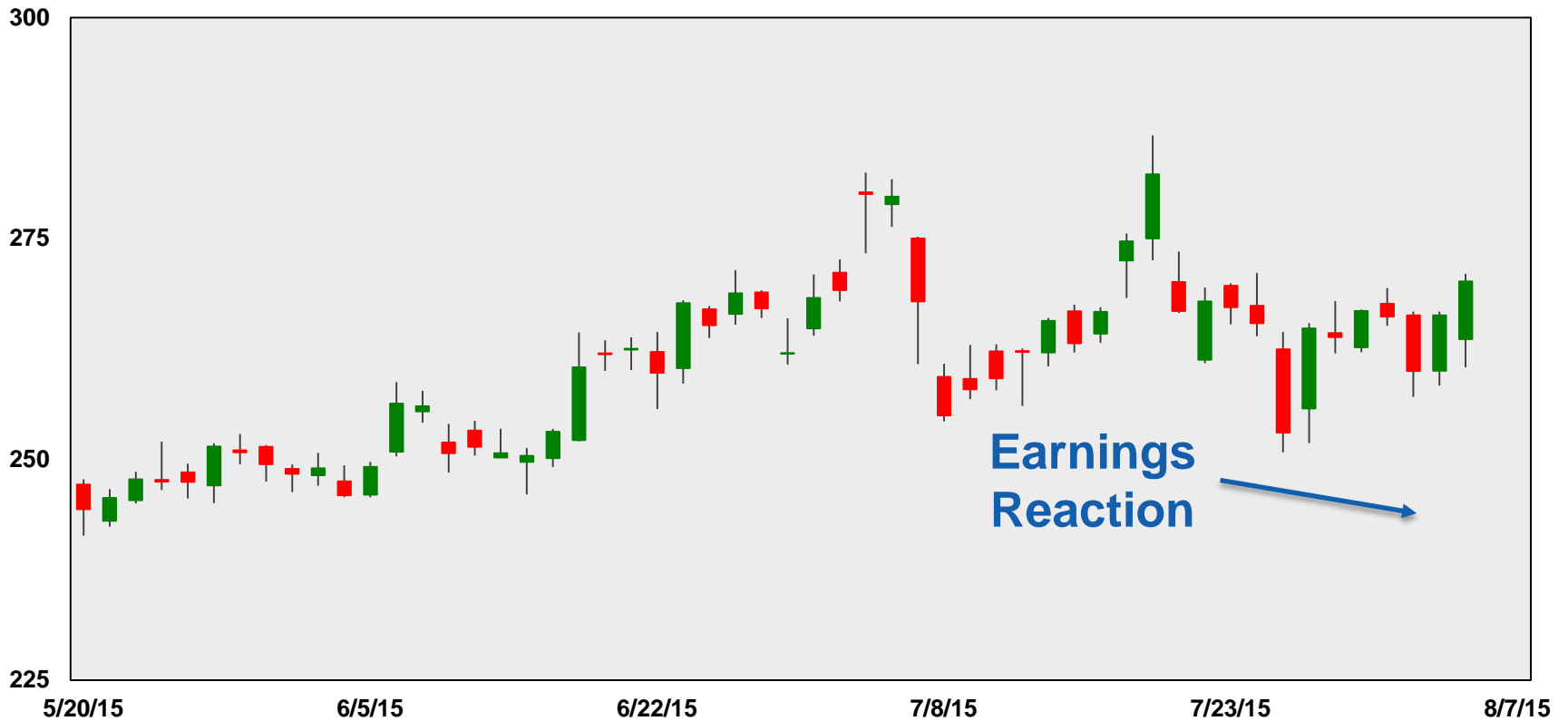
Short TSLA Aug 7th 280 Call / Long TSLA Aug 7th 305 Call



TSLA Earnings

Price Action

Daily Prices



Data Source: Bloomberg

BBY Earnings

Long Call

- **BBY reported earnings before the market open on Tuesday August 25th**
- **Just before the close on Monday with the stock trading at 29.30 (down 0.88 on the day) a trader got long BBY calls**

Three year summary of BBY earnings reactions

Max	Min	Abs Avg.	Last Q
13.24%	-13.02%	5.93%	3.94%

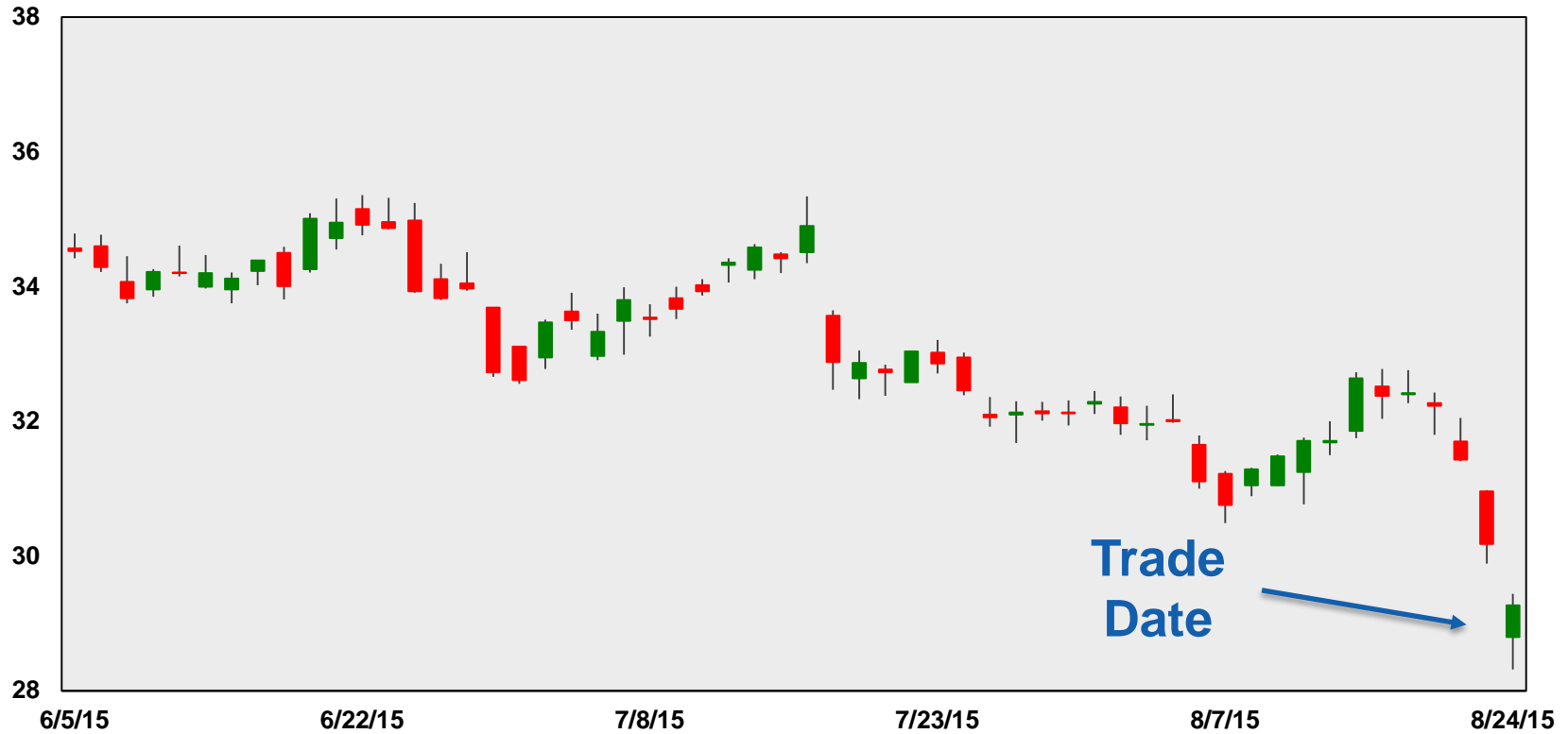
Buy 1 BBY Aug 28th 32.00 Call at 0.40

Data Source: Bloomberg

BBY Earnings

Price Action

Daily Prices

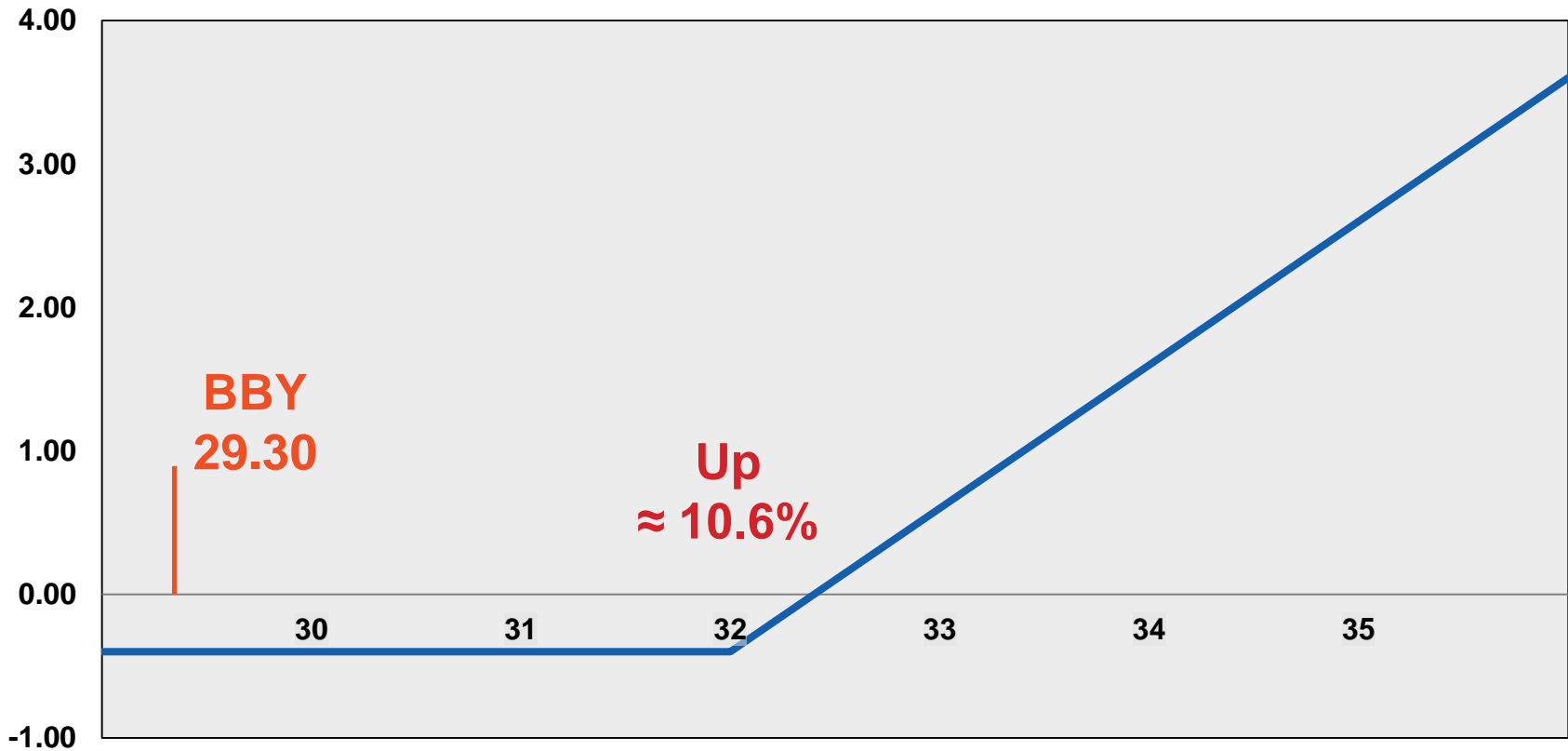


Data Source: Bloomberg

BBY Earnings

Long Call

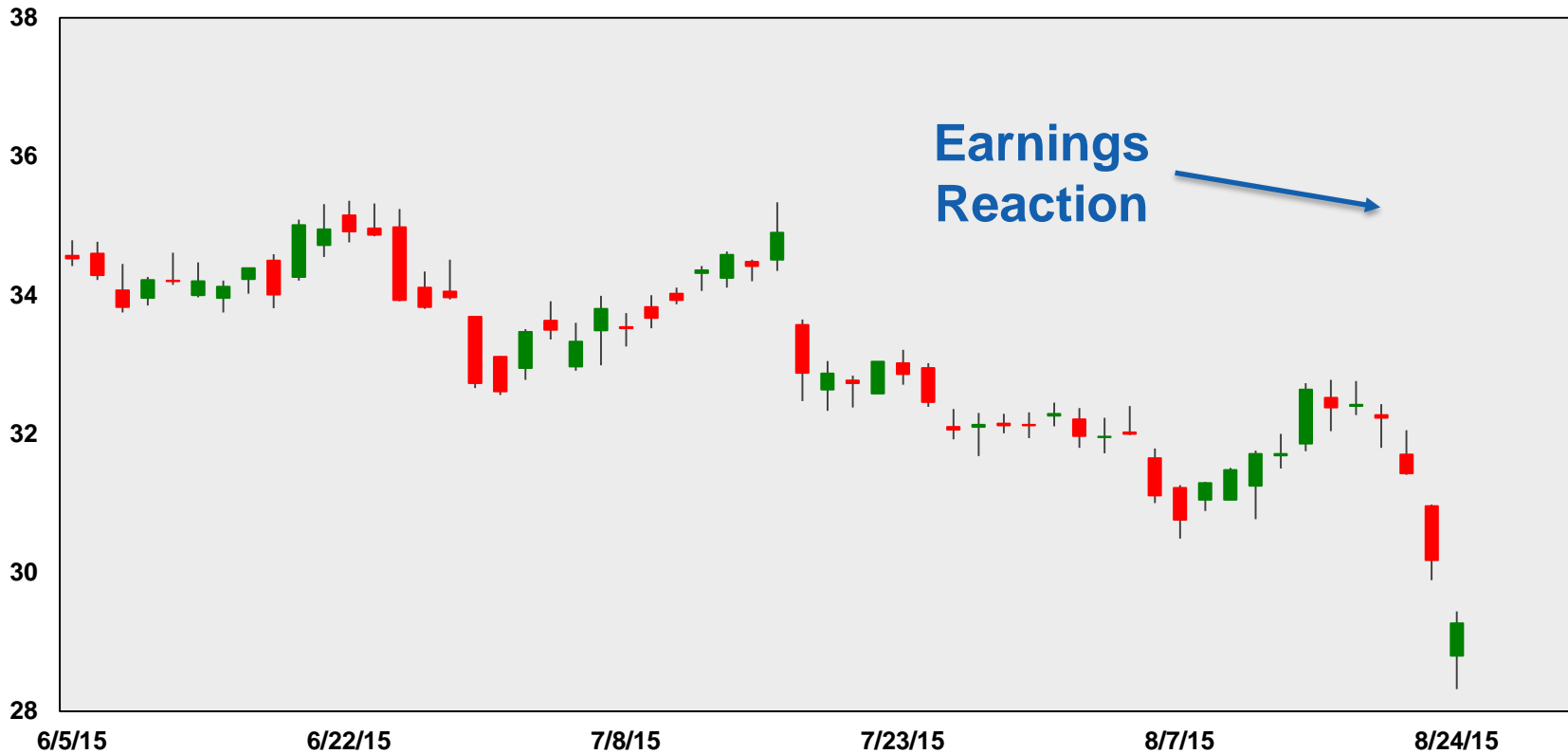
Long BBY Aug 28th 32.00 Call



BBY Earnings

Price Action

Daily Prices



Data Source: Bloomberg

GOOGL Earnings

Put Ratio Spread

- GOOGL reported earnings Thursday July 16 after the close
- There was a put ratio spread executed just before the close with GOOGL trading at 598.79

Three year summary of GOOGL earnings reactions

Max	Min	Abs Avg.	Last Q
13.80%	-8.01%	4.86%	2.91%

Sell 1 GOOGL Aug 17th 580 Put at 4.35
Buy 2 GOOGL Aug 17th 560 Puts at 1.14 (each)
Net Credit = 2.07

Data Source: Bloomberg

GOOGL Earnings

Short Call Spread

- **GOOGL reported earnings Thursday July 16 after the close**
- **There was a short call spread executed about 20 minutes before the close with GOOGL trading at 596.17**

Three year summary of GOOGL earnings reactions

Max	Min	Abs Avg.	Last Q
13.80%	-8.01%	4.86%	2.91%

Sell 1 GOOGL Aug 17th 600 Call at 9.47

Buy 1 GOOGL Aug 17th 610 Call at 5.87

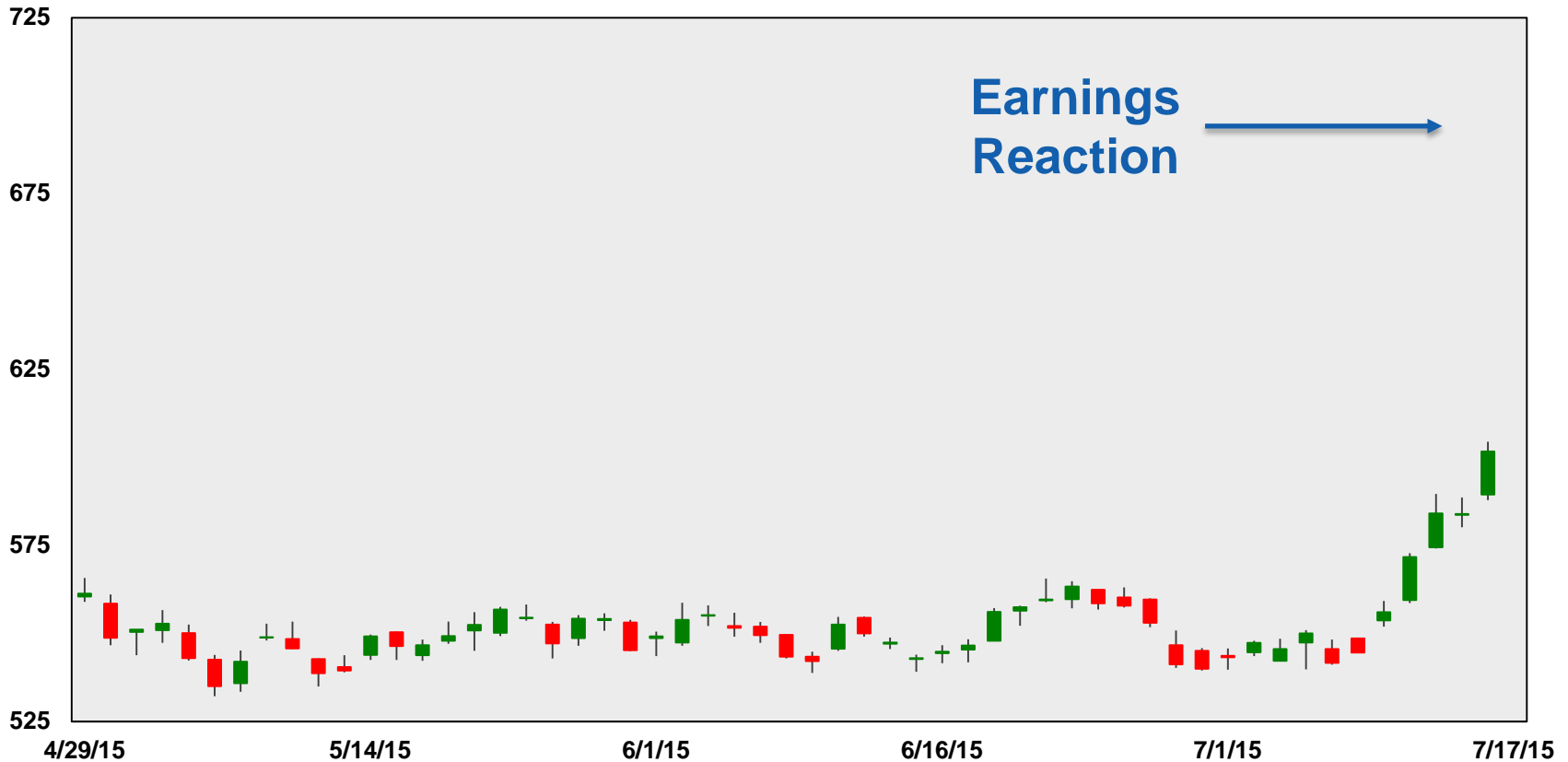
Net Credit = 3.60

Data Source: Bloomberg

GOOGL Earnings

Price Reaction

GOOGL Daily Prices –



Data Source: Bloomberg

EBAY Earnings

Iron Condor

- EBAY reported earnings Thursday July 16 before the open
- With EBAY trading at 63.38 an Iron Condor was executed late in the day on the 15th using short dated options

Max	Min	Abs Avg.	Last Q
5.69%	-2.43%	3.13%	3.98%

Buy 1 EBAY Jul 17th 58.50 Put at 0.09

Sell 1 EBAY Jul 17th 59.00 Put at 0.11

Sell 1 EBAY Jul 17th 67.00 Call at 0.19

Buy 1 EBAY Jul 17th 67.50 Call at 0.15

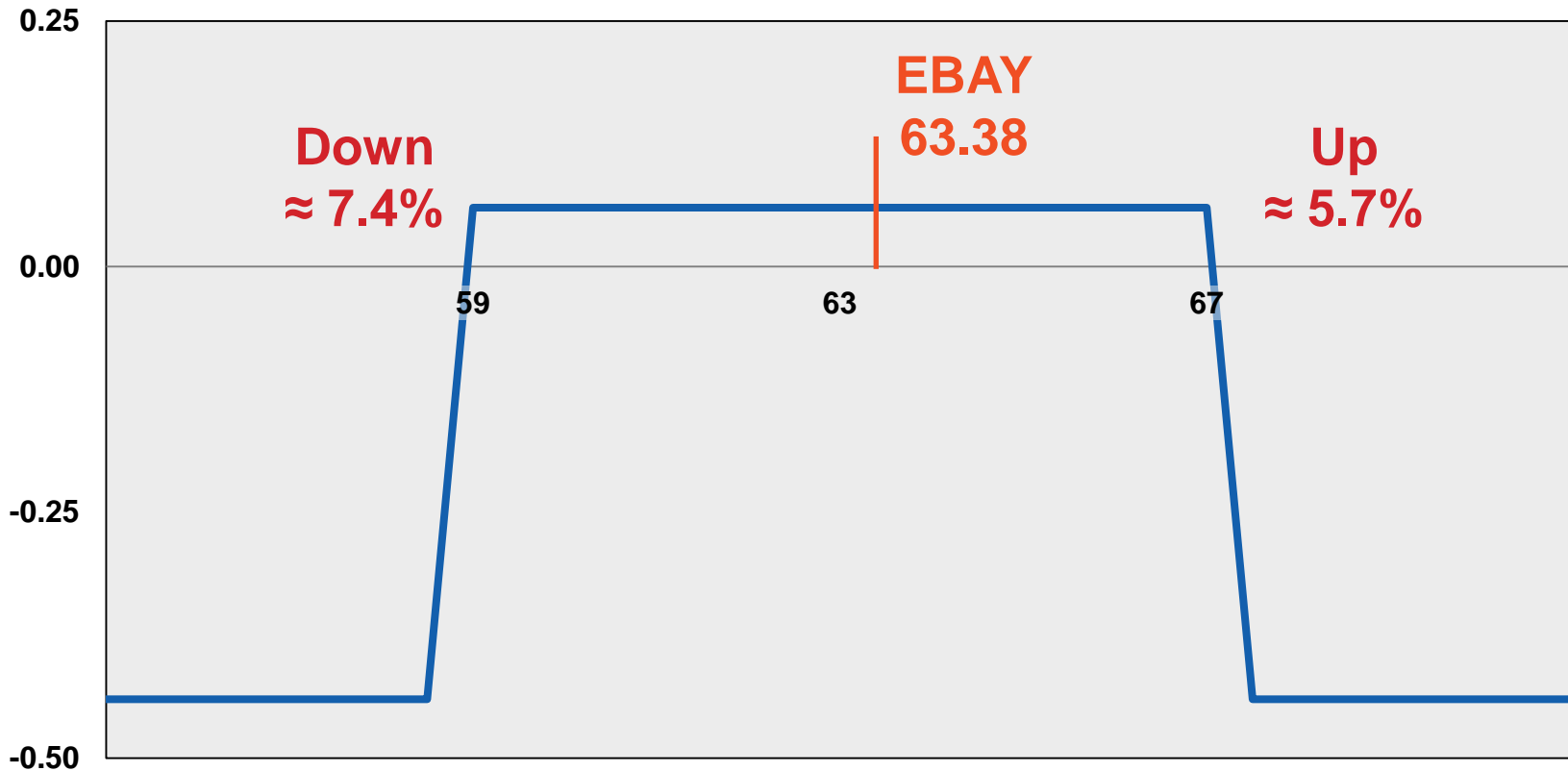
Net Credit = 0.06

Data Source: Bloomberg

EBAY Earnings

Payoff Diagram

EBAY – 58.50 – 59.00 – 67.00 – 67.50 Iron Condor



Data Source: Bloomberg

EBAY Earnings

Diagonal Spread

- EBAY reported earnings Thursday July 16 before the open
- With EBAY trading at 63.43 a Diagonal Spread was executed at the end of the trading day on 7/15

Max	Min	Abs Avg.	Last Q
5.69%	-2.43%	3.13%	3.98%

Buy 1 EBAY Aug 14th 55.00 Call at 8.70

Sell 1 EBAY Jul 17th 65.00 Call at 0.60

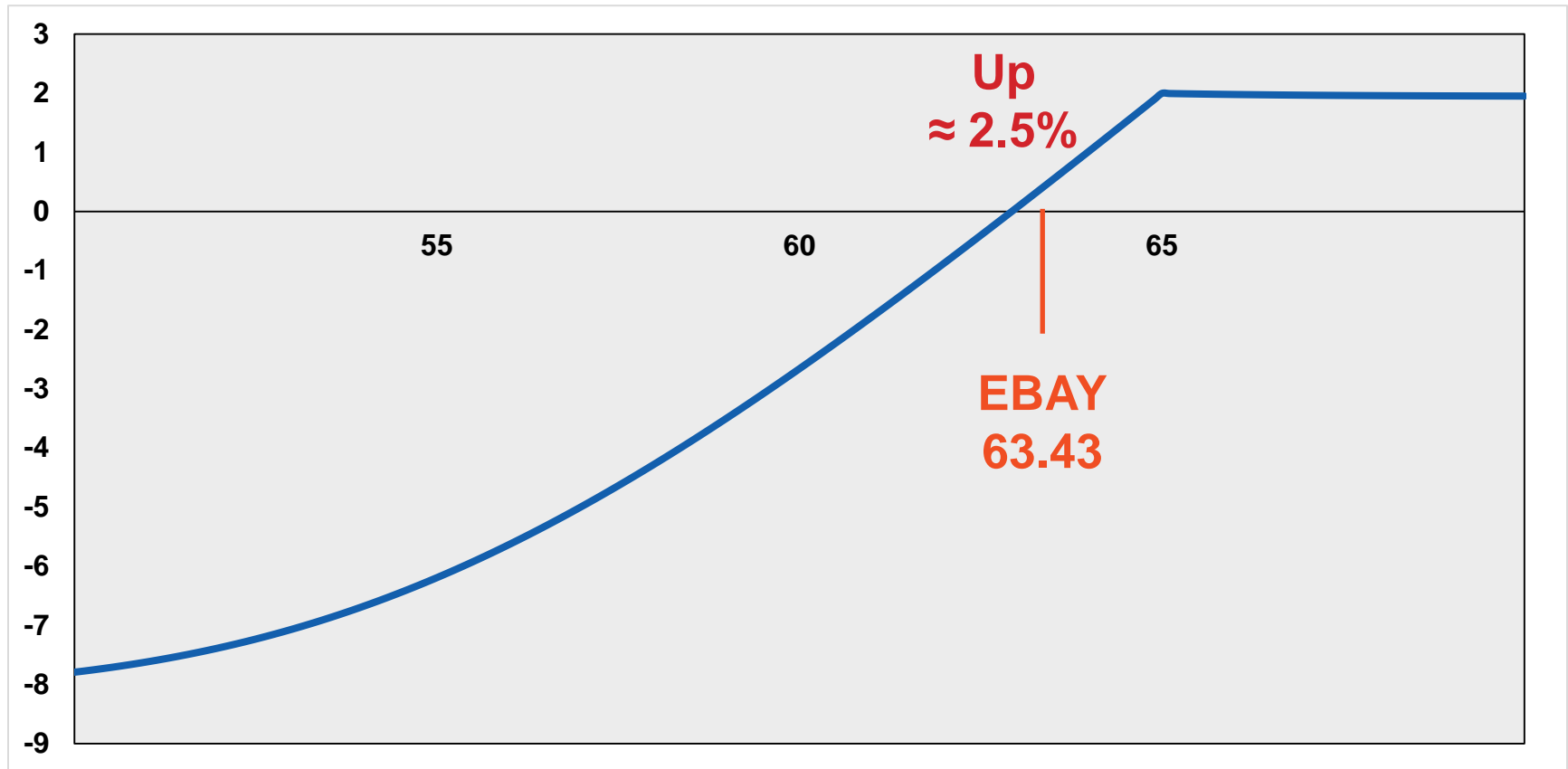
Net Cost = 8.10

Data Source: Bloomberg

EBAY Earnings

Payoff Diagram

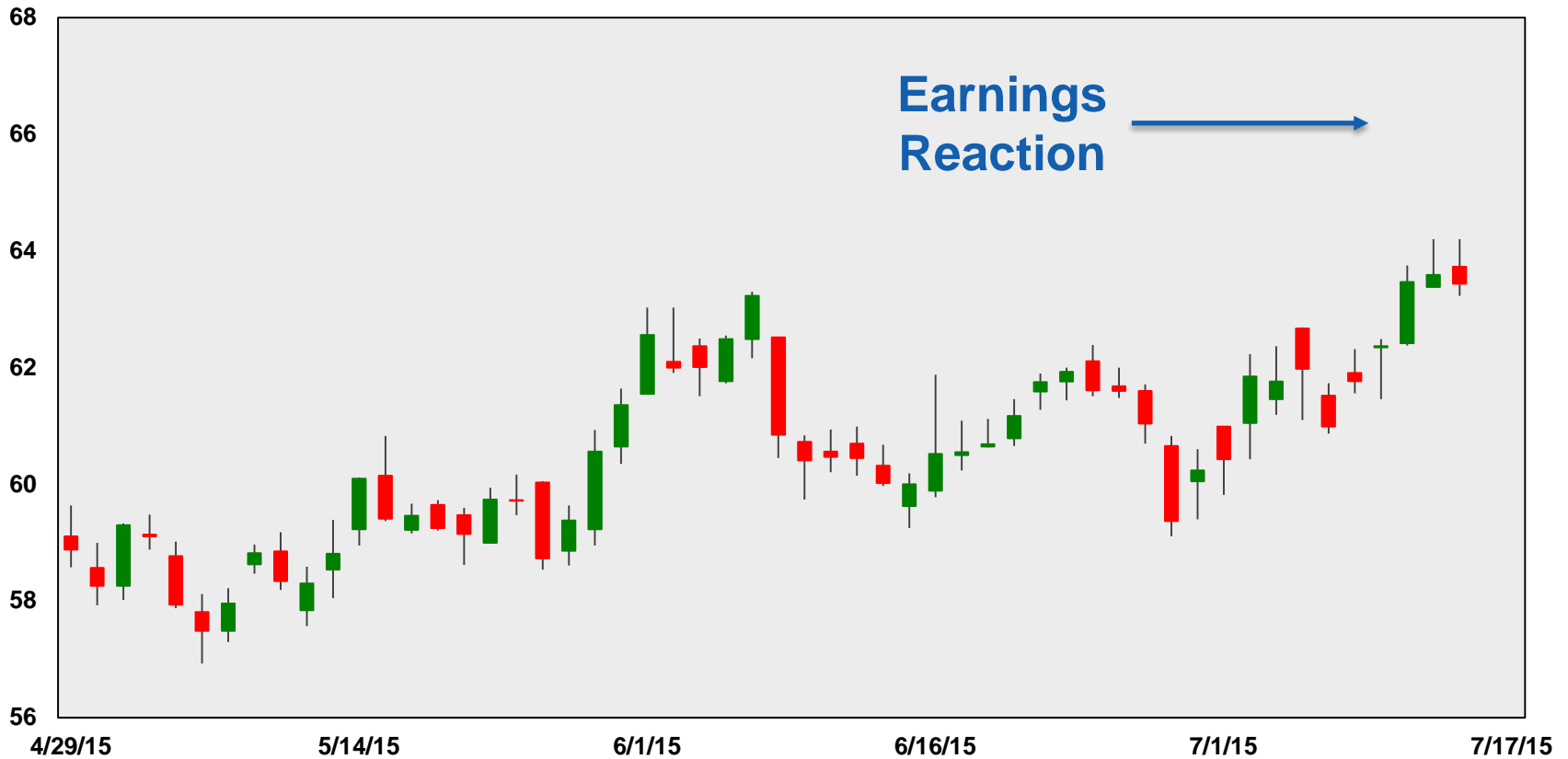
EBAY Long Aug 14th 55 Call – Short Jul 17th 65 Call



EBAY Earnings

Price Reaction

EBAY Daily Prices –



Data Source: Bloomberg

BIDU Earnings

Split Strike Long

- BIDU reported earnings Monday July 27 after the close
- Seconds before the close on Monday there was a split strike spread executed in BIDU (stock at 197.95)

Max	Min	Abs Avg.	Last Q
10.97%	-10.15%	6.81%	-8.56%

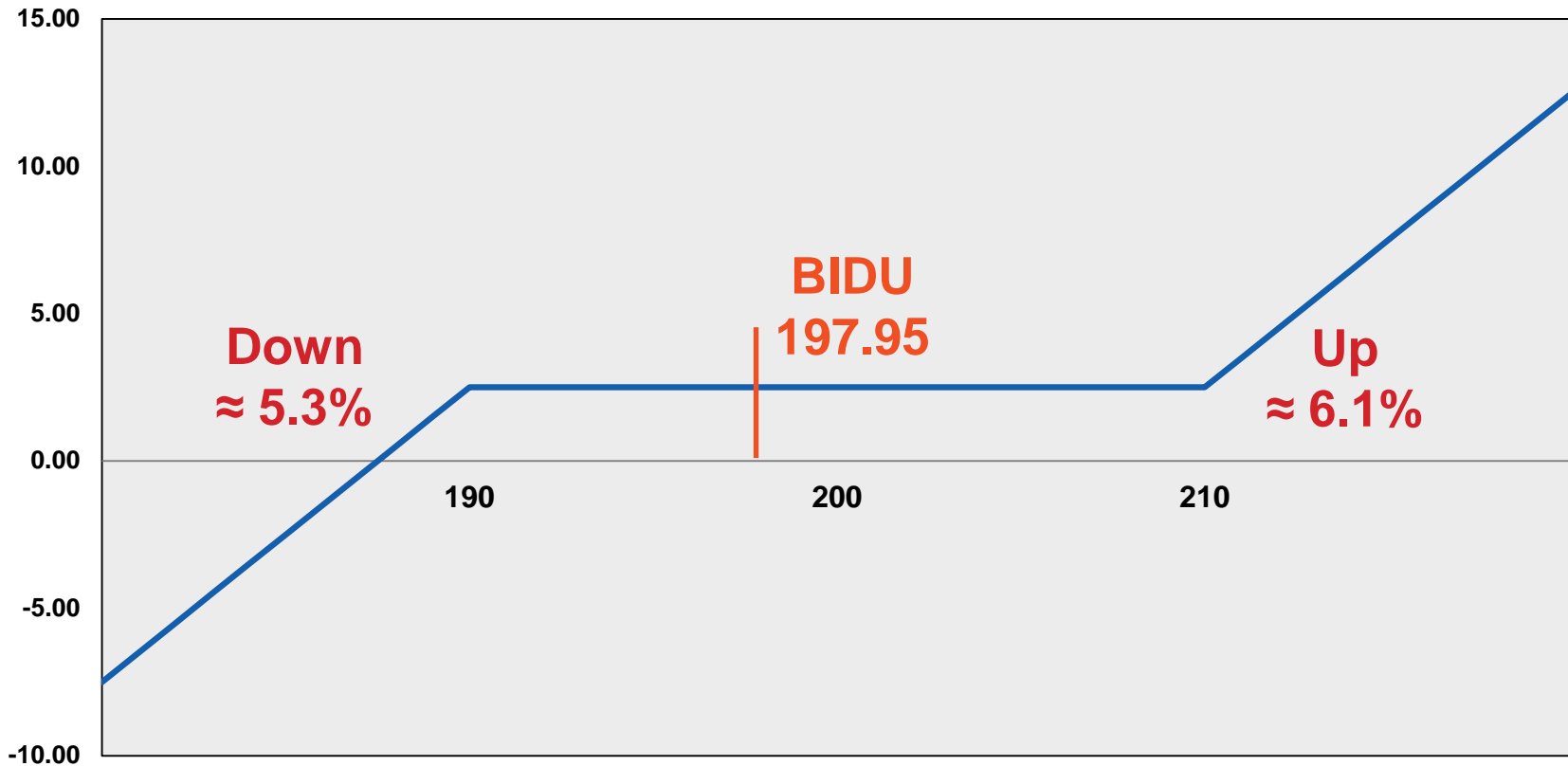
Sell 1 BIDU Jul 31st 190 Put at 6.17
Buy 1 BIDU Jul 31st 210 Call at 4.67
Net Credit = 2.50

Data Source: Bloomberg

BIDU Earnings

Short BIDU 190 Put + Long BIDU 210 Call

Payoff Diagram –



BIDU Earnings

OTM Call Spread

- BIDU reported earnings Monday July 27 after the close
- About a half hour before the market closed with BIDU at 196.87 there was an out of the money call spread in BIDU

Max	Min	Abs Avg.	Last Q
10.97%	-10.15%	6.81%	-8.56%

Sell 1 BIDU Jul 31st 230 Call at 0.86

Buy 1 BIDU Jul 31st 250 Call at 0.21

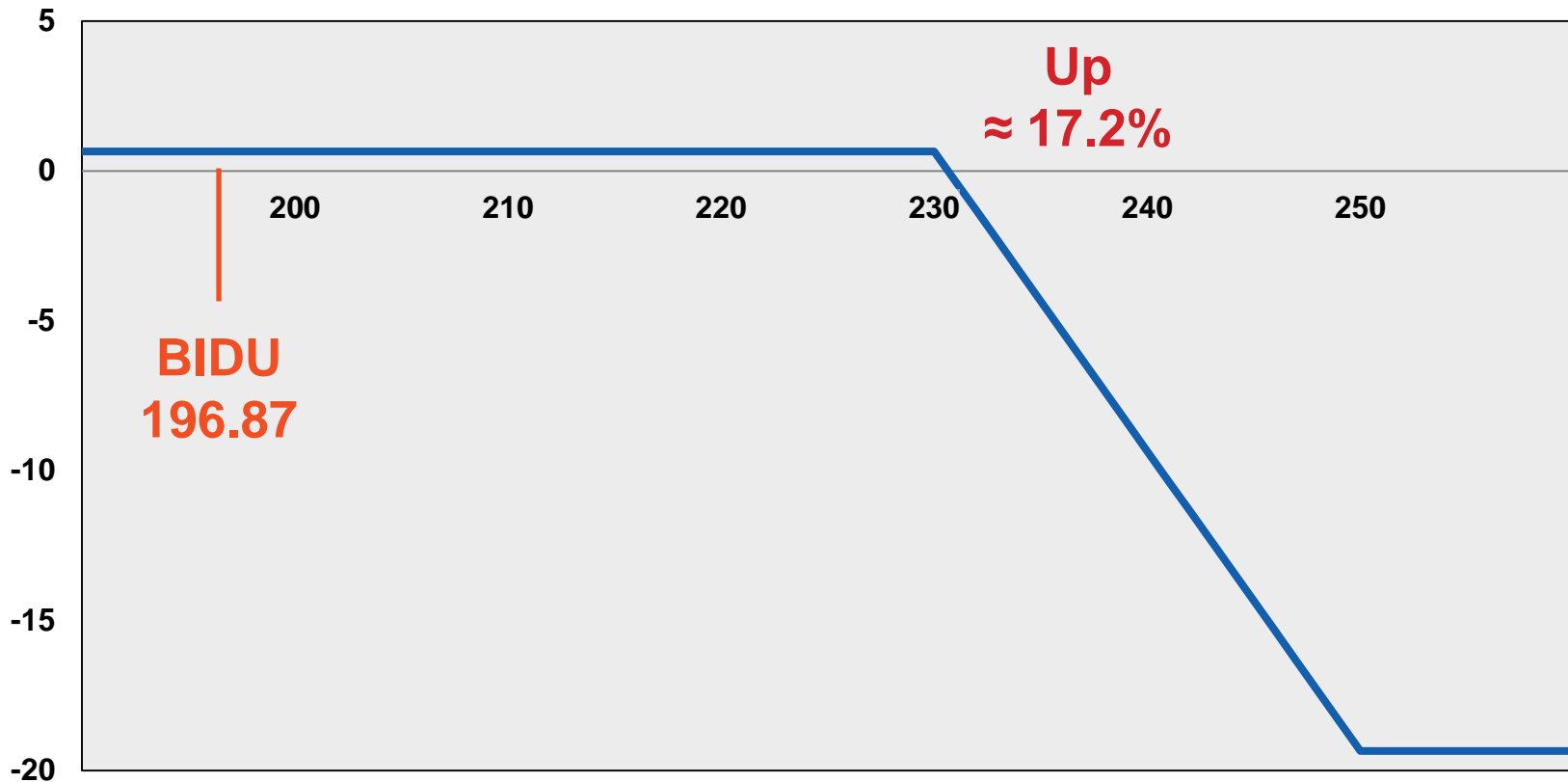
Net Credit = 0.65

Data Source: Bloomberg

BIDU Earnings

Short BIDU 230 Call + Long BIDU 250 Call

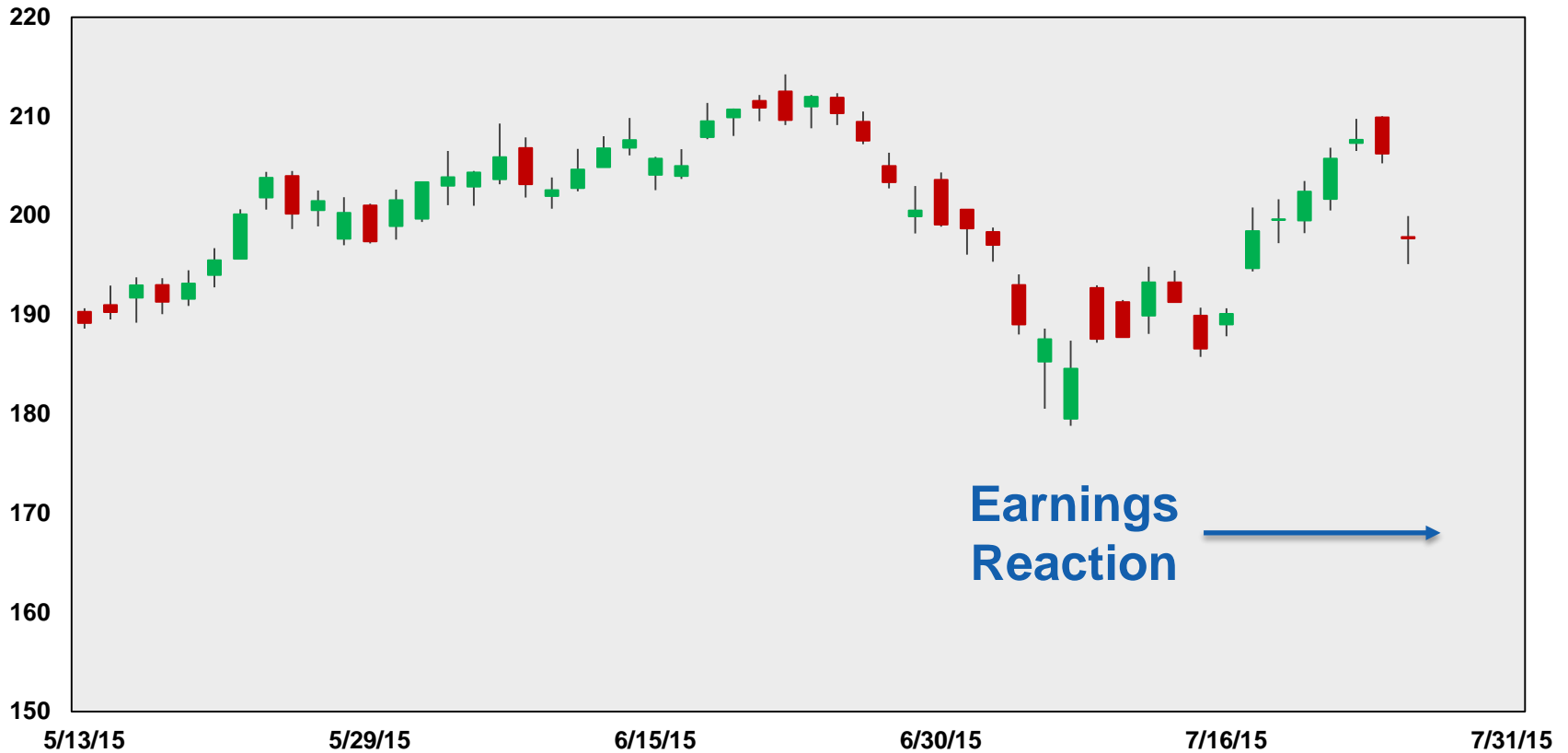
Payoff Diagram –



BIDU Earnings

Price Reaction

BIDU Daily Prices



Data Source: Bloomberg

Earnings Announcements

Summary

- **Companies are required to release earnings on a quarterly basis**
- **These events are widely anticipated and followed by investors and traders**
- **Stock prices usually move in a larger magnitude post earnings than on a average trading day**
- **There is much more to an earnings release than just the earnings number**
- **Often the most important information is contained in forward looking statements**

Earnings Announcements

Links / Contact Information

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Contact Info
rhoads@cboe.com