The Capital Fulcrum Point (CFP)

The CFP is frequently referred to in our warrants newsletters (see http://www.tipsheets.co.uk/warrantsalert.html) as a valuation indicator.

It combines the premium and the time to expiry to provide a compound indicator allowing a fair comparison across different warrants with different maturities. The CFP measures the annual percentage change required from the underlying instrument for you to do equally well in terms of capital appreciation from the warrant. If the CFP for a call warrant is 7% and the underlying instrument grows at 8% per annum, then the warrants will outperform in capital terms. Other things being equal, the lower the CFP, the cheaper the warrant. The formula for calculating the CFP, which is expressed as a percentage, is, for call warrants:

$$\text{CFP} = \left(\left(\frac{\text{exercise price}}{\text{asset price} - (\text{warrant price} * \text{cover ratio})} \right)^{1/y} - 1 \right) * 100\%$$

where y = years remaining.

An example may be useful.

Let's say that a company has shares in issue which are trading in the market at 110p, and its warrants are exercisable into one share each at 125p in three years' time. The warrant price in the market is 20p. With this information we can calculate the CFP.

Step 1: take the asset price (110p) and subtract the warrant price (multiplied by the cover ratio if applicable) of 20p. The answer is 90p.

Step 2: divide the exercise price (125p) by the answer from Step 1 (90p). This comes to 1.3888.

Step 3: raise 1.3888 to the power of 1/3. This answer is 1.1157.

Step 4: subtract 1 and then multiply by 100. The answer is 11.57%.

There is a CFP calculator available on our website at http://www.tipsheets.co.uk/cfp.html which you can use to help.