

Letter To The Editor, Business Valuation Update, January 2009
The Effects of Current Economic Troubles on Discounts For Lack of Marketability

Your October 1, 2008 issue of BVUpdate included an article headed, “Reduced liquidity may lead to larger marketability discounts in the current economy” in which Lance Hall said “it makes sense that cash flows might decrease in an analysis, and discounts might also increase.” In a letter to the Editor, I responded that it would not be difficult to prove that statement with a study of the current costs of publicly traded LEAPS put options compared to costs in some earlier period. While in the process of preparing an exhaustive study of 2008 discounts for lack of marketability based on LEAPS, I decided to address the issue.

The conclusion is that Lance Hall is exactly right. In fact, discounts for lack of marketability in late November 2008 are more than double those in August 2006, and, in virtually every case, the underlying stock prices per share are much lower as well.

Discounts for Lack of Marketability Based On LEAPS

Date of study: Option length: (months)	<u>August, 2006</u>		<u>November, 2008</u>		<u>% Change:</u>	
	17	29	14	26	2010/ 2008	2011/ 2009
	<u>2008 Option</u>	<u>2009 Option</u>	<u>2010 Option</u>	<u>2011 Option</u>		
Mean	15.3%	19.1%	33.8%	40.5%	220%	212%
Median	13.4%	17.1%	31.9%	38.6%	238%	226%
Range of	10.1% to	12.9% to	25.7% to	32.0% to	255% to	247% to
Middle 50%	18.6%	22.9%	38.7%	47.0%	208%	205%
Company counts	283	283	259	180		

The 283 companies are all of the companies whose names begin with the letters A through F and who had LEAPS put options available for purchase on both study dates. As in my prior studies, the discount is calculated as the cost of the put option divided by the price of the stock. For further details, read the entire 2006 study at www.dlom-info.com.

In the November 2008 study, company counts are significant for two reasons. First, despite the major increases in option costs (which resulted in higher discounts) and a three-month shorter option period, market makers in 2008 did not offer a two-year option (2011 option) for 103 companies that they sold options for in 2006 (the 2009 option) – clearly a reflection of long-term risk in the market. Second, the difference between 283 companies in 2006 and 259 companies in 2008 (24 companies) is due almost exclusively to the fact that in 2008 the stock of these companies sold for well below the minimum option price of \$2.50 per share; so no meaningful discount could be calculated.

It is also an interesting result of perceived market risk in 2008 that the absolute percentage spread (i.e., the cost of the option) between the one-year (the 14-month or 17-month option) and the two-year option (the 26-month or 29-month option) has increased from the 3% to 4% range in 2006 to the 7% to 8% range in 2008.