

Discounts For Lack of Marketability And
The 2008 – 2009 Recession

Do discounts for lack of marketability change with economic conditions? Our earlier studies proved that discounts are not stable and that they vary by company, industry, size, economic conditions and other variables.¹ The 2008 study, which showed large discounts, was done on stock prices and options at the end of November 2008. This raised the question of how much and to what extent LEAPS put options and the costs of price protection have changed since then. This paper reports on the costs of price protection or implied discounts for lack of marketability in mid-June 2009 (June 10 through June 22, to be exact) compared to November 2008.

As a basis for comparison, let us review the overall results from our first study of LEAPS put options available for purchase in August 2006:

	<u>August 2006 LEAPS</u>	
	<u>Jan. 2008</u>	<u>Jan. 2009</u>
	<u>Expiration</u>	<u>Expiration</u>
Months to Expiration	18	30
Count	906	897
Median	13.9%	17.4%
Average	16.3%	20.5%
25th Percentile	10.5%	13.4%
75th Percentile	19.2%	23.9%

In hindsight, August 2006 seems to have been a more “normal” economic climate than either November 2008 or June 2009. At that time, the range of the middle 50% of discounts (or costs of price protection) for the 30-month period was from 13% to 24%.

By November 2008, the expiration period of the put options had shortened; many fewer companies offered the longer option; and costs of price protection had sky rocketed. The range of the middle 50% of discounts for the 26-month period was from 34% to 49%.

¹ “Minimum Marketability Discounts – 3rd Edition,” September 2007 and “Minimum Marketability Discounts – 4th Edition,” March 2009, both by Ronald M. Seaman, FASA, available for download at www.dlom-info.com

	<u>November 2008 LEAPS</u>	
	<u>Jan. 2010 Expiration</u>	<u>Jan. 2011 Expiration</u>
Months to Expiration	14	26
Count	1036	623
Median	33.5%	40.6%
Average	36.4%	43.2%
25th Percentile	27.4%	34.0%
75th Percentile	41.7%	49.2%

By June 2009 the perceptions of risk in the market had changed again, and, of course, the expiration dates of the 2010 and 2011 options had shortened by seven months. Our sample was of the first 25%, alphabetically, of companies that had LEAPS options available in November 2008. We did not include companies whose stock price in November was lower than the lowest price option sold (\$2.50).

That comparison was as follows:

	<u>November 2008 LEAPS</u>		<u>June 2009 LEAPS</u>	
	<u>Jan. 2010 Expiration</u>	<u>Jan. 2011 Expiration</u>	<u>Jan. 2010 Expiration</u>	<u>Jan. 2011 Expiration</u>
Months to Expiration	14	26	7	19
Count	256	164	259	166
Median	33.9%	41.3%	16.5%	25.1%
Average	36.1%	43.0%	17.9%	26.8%
25th Percentile	27.6%	33.6%	13.4%	20.6%
75th Percentile	40.7%	48.7%	20.6%	30.6%

By June 2009, the time to expiration of the put options had shortened; no higher percentage of longer term options (the January 2011 expiration) was available than in November; but the discounts were roughly one-third to one-half lower than in November. The range of the middle 50% of discounts for the 19-month period was from 21% to 31%.

Certainly, some portion of that change/decrease was caused by the passage of time; i.e., seven months closer to the expiration date, although we can not determine how much.

Some observations are possible from this data:

- a) As before, we note that discounts for lack of marketability change over time. They are not static. Discounts change for a number of reasons. This study points out two obvious reasons: one is market conditions; the other is the period of time, or, in appraisal parlance, the holding period.

Further study of the differences in discounts between the two time periods for LEAPS options might shed some light on a “normal” amount of discount decrease as the time to expiration becomes shorter.

- b) The discount or cost of price protection on the shorter term LEAPS option (the 2010 option) decreased 50% to 51% over the seven-month period;
- c) The discount or cost of price protection on the longer term LEAPS option (the 2011 option) decreased 38% to 39% over the seven-month period;
- d) The difference between these two numbers (in paragraphs b) and c) above) suggests that much of the decrease in discounts is from stabilization of the market (i.e., decreased risk) as most prices per share of the underlying stocks increased significantly between November 2008 and June 2009.
- e) It is interesting to note that, with only seven months remaining until expiration – what most valuers of closely-held stock would consider a very short holding period – the median discount of the January 2010 option was still 16.5%. The January 2011 option that expires in 19 months had a median discount of 25.1%.