

How To Use LEAPS

To Determine A Discount for Lack of Marketability

by

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In general, LEAPS can be used in many of the same ways as the restricted stock studies, except there are 1000 LEAPS versus 500 or so restricted stock transactions. In addition to being industry specific and company specific, LEAPS are valuation date specific.

In many valuations we determine a “base” or a “benchmark” from which to increase or decrease the DLOM to arrive at a conclusion. The Tax Court, in its Mandelbaum¹ decision, said “...we use these figures (from 35% to 45%) as benchmarks of the marketability discount for the shares at hand.” In the Jelke² case, the Court repeatedly used descriptions such as “...(this factor) should also favor a lower-than-average discount.” In both cases, the Court had an implicit benchmark although in neither case was that benchmark defined or substantiated. LEAPS can provide a provable benchmark.

The Assignment

To illustrate how this can be done, let us use an example from an actual appraisal done in 2007, with the facts modified and updated. The client was a small regional stock brokerage company with 2007 revenues of \$9,800,000. It had been continuously profitable for many years and had no debt. The company had been in business for over 20 years and had 52 employees of whom 24 were brokers. The interest to be valued was 3.0% of the common stock. There were 32 total shareholders, none of whom had a controlling interest. The subject company was growing at

¹ Bernard Mandelbaum, et al. v. Commissioner, T.C. Memo 1995-255, p. 24.

² Estate of Frazier Jelke, III v. Commissioner, T.C. Memo 2005-131, p.40.

about the same rate as the industry and had paid modest cash distributions. The valuation date is February 15, 2008.

Step 1: Define Guideline Public Companies

The first step is to define the industry and obtain a list of public companies in that industry, using SIC or NAICS codes or the website Yahoo Finance. Define the industry as finely as possible. For example, with this assignment in Yahoo Finance, we went from “Finance Search,” to “Stocks By Industry,” to the “Finance” industry, to “Investment Brokerage – National,” and finally to “Investment Brokerage – Regional.” This search listed 30 companies in “Investment Brokerage – Regional” and 25 companies in “Investment Brokerage – National.” While at these sites, it is helpful to download to a spreadsheet the financial data of the companies.

Step 2: Determine Which Companies Have LEAPS

This can be done easily by accessing the alphabetical listing of LEAPS at the website of the Chicago Board of Exchange, <http://www.cboe.com/TradTool/Symbols/symbolall.aspx>. Or, from the CBOE home page, click on “Products,” then “LEAPS” from the drop down menu. Under “LEAPS Resources,” click on “Equity Options and LEAPS Symbol Directory.”

For our assignment, there are ten “national” brokerage companies and three “regional” brokerage companies that have LEAPS. On the Yahoo financial spreadsheet you downloaded earlier, delete those companies that do not have LEAPS. The result is shown in Exhibit I,

Step 3: Order LEAPS Prices For Your Valuation Date

The Chicago Board of Exchange website, www.marketdataexpress.com, provides historical options data for each day on which the stock exchanges are open. They claim that options data is available for the past 16 years. (Note, however, that LEAPS only began in 1990.) You will have to create an account. On the home page, click on “Search Data.” On the “Search Page, Step 1,” select “Equities.” Then, order by stock symbol and trading date. The cost (as of December, 2010) is \$3.00 per stock symbol per day. You will receive a print out like the one in Exhibit II showing all options available for each symbol on your valuation date. The LEAPS options information you will need is highlighted. You can get a chart that interprets the column-heading abbreviations at the Market Data Express website, “Bulk Data” tab, in the second paragraph where it says, “For product information and sample of Optsum *click here.*”

Step 4: Calculate Costs of Price Protection On Your Valuation Date

Using the options information from Market Data Express, calculate the cost of a put option as a percentage of the stock price on the valuation date. In our studies of LEAPS we adjust the option cost if it is more than 1% different from the stock price. We call this a “Distance Weighted Option Cost.” It is simply the relationship between the actual stock price and the next higher and lower strike prices. For example, a stock trading at \$36.06 per share on your valuation date has put options at \$35.00 at a cost of \$5.10 and at \$40.00 at a cost of \$7.90. The “Distance Weighted Option Cost.” of a put option for \$36.06 is a straight-line percentage increase in the actual option cost difference between \$35.00 and \$40.00. Thus, the stock price, \$36.06, is \$1.06 above the \$35.00 strike price, or 21.2% of the \$5.00 difference in strike prices ($\$1.06 \div \5.00). The difference in put option costs is \$2.80 ($\$7.90 - \5.10). So we add 21.2% of the

difference ($\$2.80 \times .212 = \0.59) to the lower option cost ($\$5.10$) to arrive at a “Distance Weighted Option Cost” of $\$5.69$. Dividing that by the stock price results in a percentage cost of 15.8% ($\$5.69 \div \36.06).

Exhibit I

Step 2: Brokerage Firms With LEAPS

| <u>Description</u> | <u>Symbol</u> | <u>Market Cap (\$)</u> | <u>P/E</u> | <u>ROE %</u> | <u>Div. Yield %</u> | <u>Debt To Equity</u> | <u>Price to Book</u> | <u>Net Profit Margin</u> | <u>Price To Free C.F.</u> |
|---------------------------------|---------------|------------------------|------------|--------------|---------------------|-----------------------|----------------------|--------------------------|---------------------------|
| Investment Brokerage - National | | 260.34B | 29.0 | 9.4 | 1.6 | 12.0 | 2.4 | 4.4 | -1.4 |
| Investment Brokerage - Regional | | 51.16B | 23.2 | 9.8 | 1.7 | 0.7 | 9.1 | 11.7 | -76.7 |
| Charles Schwab Corp. | SHQ | 22.07B | 9.7 | 25.6 | 1.1 | 0.2 | 5.9 | 22.9 | NA |
| E*TRADE Financial Corporation | ETFC | 1.73B | NA | -41.0 | NA | 6.9 | 0.6 | NA | NA |
| Goldman Sachs Group Inc. | GS | 63.37B | 6.5 | 29.5 | 0.9 | 10.2 | 1.6 | 29.9 | NA |
| Lehman Brothers Holdings Inc. | LEH | 24.60B | 6.4 | 20.1 | 1.5 | 18.2 | 1.2 | 20.2 | NA |
| Merrill Lynch & Co., Inc. | MER | 43.90B | NA | -24.3 | 3.1 | 18.2 | 1.5 | NA | NA |
| Morgan Stanley | MS | 44.03B | 13.4 | 7.7 | 2.7 | 16.8 | 1.4 | NA | NA |
| optionsXpress Holdings, Inc. | OXPS | 1.31B | 13.4 | 42.6 | 1.5 | NA | 4.7 | 40.7 | NA |
| SEI Investments Co. | SEIC | 4.69B | 18.8 | 37.5 | 0.6 | 0.1 | 6.2 | 15.2 | 39.1 |
| TD AMERITRADE Holding Corp. | AMTD | 10.03B | 13.8 | 35.8 | 0.0 | 0.6 | 4.2 | 39.1 | NA |
| The Bear Stearns Companies | BSC | 9.54B | 46.0 | 1.9 | 1.8 | 19.5 | 0.8 | NA | NA |
| Friedman Billings Ramsey Group | FBR | 288.6M | NA | -84.4 | 10.2 | 5.4 | 0.7 | NA | NA |
| Knight Capital Group Inc. | NITE | 1.54B | 13.4 | 13.4 | NA | 0.1 | 1.7 | 19.3 | NA |
| Legg Mason Inc. | LM | 8.52B | 13.1 | 10.4 | 1.5 | 0.2 | 1.2 | 13.0 | -21.5 |

Exhibit II Step 3

| TRADE_DT | UNDLY | CLS | EXPR_DT | STRK_PRC | PC | OIT | VOL | HIGH | LOW | OPEN | LAST | L_BID | L_ASK | UNDL_PRC | S_TYPE | P_TYPE |
|----------|-------|-----|----------|----------|----|------|--------|------|-----|------|------|-------|-------|----------|---------------|--------|
| 20080215 | NITE | OTI | 20090117 | 10 | C | 420 | 0 | 0 | 0 | 0 | 0 | 7.5 | 7.9 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 10 | P | 86 | 0 | 0 | 0 | 0 | 0 | 0.5 | 0.65 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 12.5 | C | 479 | 0 | 0 | 0 | 0 | 0 | 5.6 | 5.9 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 12.5 | P | 253 | 0 | 0 | 0 | 0 | 0 | 1.1 | 1.25 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 15 | C | 350 | 0 | 0 | 0 | 0 | 0 | 4 | 4.3 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 15 | P | 435 | 0 | 0 | 0 | 0 | 0 | 1.9 | 2.05 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 17.5 | C | 5877 | 0 | 0 | 0 | 0 | 0 | 2.7 | 2.95 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 17.5 | P | 398 | 0 | 0 | 0 | 0 | 0 | 3 | 3.2 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 20 | C | 1689 | 0 | 0 | 0 | 0 | 0 | 1.7 | 1.95 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 20 | P | 87 | 0 | 0 | 0 | 0 | 0 | 4.5 | 4.7 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 22.5 | C | 419 | 0 | 0 | 0 | 0 | 0 | 1 | 1.15 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 22.5 | P | 30 | 0 | 0 | 0 | 0 | 0 | 6.2 | 6.5 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 25 | C | 402 | 0 | 0 | 0 | 0 | 0 | 0.55 | 0.75 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 25 | P | 0 | 0 | 0 | 0 | 0 | 0 | 8.3 | 8.6 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 30 | C | 61 | 0 | 0 | 0 | 0 | 0 | 0.1 | 0.25 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 30 | P | 0 | 0 | 0 | 0 | 0 | 0 | 13 | 13.6 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 5 | C | 1 | 0 | 0 | 0 | 0 | 0 | 11.9 | 12.2 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 5 | P | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0.15 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 7.5 | C | 33 | 0 | 0 | 0 | 0 | 0 | 9.6 | 10 | 16.88 | Leap | Equity |
| 20080215 | NITE | OTI | 20090117 | 7.5 | P | 55 | 0 | 0 | 0 | 0 | 0 | 0.15 | 0.3 | 16.88 | Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 10 | C | 160 | 0 | 0 | 0 | 0 | 0 | 6.9 | 7.1 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 10 | P | 176 | 0 | 0 | 0 | 0 | 0 | 0 | 0.1 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 12.5 | C | 1987 | 0 | 0 | 0 | 0 | 0 | 4.6 | 4.8 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 12.5 | P | 2467 | 0.0005 | 0 | 0 | 0 | 0 | 0.15 | 0.3 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 15 | C | 983 | 0 | 0 | 0 | 0 | 0 | 2.6 | 2.75 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 15 | P | 708 | 0 | 0 | 0 | 0 | 0 | 0.65 | 0.75 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 17.5 | C | 923 | 0 | 0 | 0 | 0 | 0 | 1.15 | 1.25 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 17.5 | P | 395 | 2 | 1.8 | 1.8 | 1.8 | 1.8 | 1.65 | 1.8 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 20 | C | 332 | 0 | 0 | 0 | 0 | 0 | 0.35 | 0.45 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 20 | P | 234 | 0 | 0 | 0 | 0 | 0 | 3.3 | 3.6 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 22.5 | C | 113 | 0 | 0 | 0 | 0 | 0 | 0.05 | 0.15 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 22.5 | P | 0 | 0 | 0 | 0 | 0 | 0 | 5.5 | 5.8 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 7.5 | C | 64 | 0 | 0 | 0 | 0 | 0 | 9.3 | 9.6 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080419 | 7.5 | P | 42 | 0 | 0 | 0 | 0 | 0 | 0 | 0.05 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 10 | C | 41 | 0 | 0 | 0 | 0 | 0 | 6.8 | 7 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 10 | P | 10 | 0 | 0 | 0 | 0 | 0 | 0 | 0.05 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 12.5 | C | 172 | 0 | 0 | 0 | 0 | 0 | 4.3 | 4.5 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 12.5 | P | 298 | 0 | 0 | 0 | 0 | 0 | 0 | 0.05 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 15 | C | 990 | 10 | 1.9 | 1.9 | 1.9 | 1.9 | 1.8 | 2 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 15 | P | 668 | 0 | 0 | 0 | 0 | 0 | 0 | 0.05 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 17.5 | C | 1293 | 0 | 0 | 0 | 0 | 0 | 0 | 0.05 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 17.5 | P | 300 | 0 | 0 | 0 | 0 | 0 | 0.5 | 0.65 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 20 | C | 200 | 0 | 0 | 0 | 0 | 0 | 0 | 0.05 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 20 | P | 0 | 0 | 0 | 0 | 0 | 0 | 3 | 3.2 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 7.5 | C | 1 | 0 | 0 | 0 | 0 | 0 | 9.3 | 9.5 | 16.88 | Leap non-Leap | Equity |
| 20080215 | NITE | QTN | 20080216 | 7.5 | P | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0.05 | 16.88 | non-Leap | Equity |

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| | | | | | | | | | | | | | | Leap | | |
|----------|------|-----|----------|------|---|------|----|------|------|------|------|------|------|-------|----------|--------|
| 20080215 | NITE | QTN | 20080719 | 10 | C | 0 | 0 | 0 | 0 | 0 | 0 | 7.1 | 7.3 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 10 | P | 27 | 0 | 0 | 0 | 0 | 0 | 0.15 | 0.3 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 12.5 | C | 67 | 0 | 0 | 0 | 0 | 0 | 5 | 5.3 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 12.5 | P | 230 | 0 | 0 | 0 | 0 | 0 | 0.55 | 0.7 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 15 | C | 2902 | 9 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.5 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 15 | P | 2334 | 0 | 0 | 0 | 0 | 0 | 1.35 | 1.4 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 17.5 | C | 491 | 1 | 1.9 | 1.9 | 1.9 | 1.9 | 1.95 | 2.05 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 17.5 | P | 167 | 5 | 2.45 | 2.45 | 2.45 | 2.45 | 2.35 | 2.5 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 20 | C | 138 | 0 | 0 | 0 | 0 | 0 | 1 | 1.1 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 20 | P | 0 | 0 | 0 | 0 | 0 | 0 | 3.9 | 4.1 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 22.5 | C | 66 | 0 | 0 | 0 | 0 | 0 | 0.45 | 0.55 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 22.5 | P | 0 | 0 | 0 | 0 | 0 | 0 | 5.8 | 6 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 7.5 | C | 0 | 0 | 0 | 0 | 0 | 0 | 9.3 | 9.7 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080719 | 7.5 | P | 20 | 0 | 0 | 0 | 0 | 0 | 0 | 0.1 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 10 | C | 0 | 0 | 0 | 0 | 0 | 0 | 6.8 | 7 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 10 | P | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0.05 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 12.5 | C | 1 | 0 | 0 | 0 | 0 | 0 | 4.4 | 4.6 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 12.5 | P | 1548 | 0 | 0 | 0 | 0 | 0 | 0.05 | 0.15 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 15 | C | 424 | 0 | 0 | 0 | 0 | 0 | 2.25 | 2.4 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 15 | P | 1581 | 0 | 0 | 0 | 0 | 0 | 0.35 | 0.45 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 17.5 | C | 893 | 23 | 0.9 | 0.6 | 0.9 | 0.6 | 0.7 | 0.8 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 17.5 | P | 339 | 0 | 0 | 0 | 0 | 0 | 1.25 | 1.35 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 20 | C | 588 | 0 | 0 | 0 | 0 | 0 | 0.1 | 0.2 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 20 | P | 1000 | 0 | 0 | 0 | 0 | 0 | 3.1 | 3.3 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 7.5 | C | 0 | 0 | 0 | 0 | 0 | 0 | 9.2 | 9.5 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | QTN | 20080321 | 7.5 | P | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0.05 | 16.88 | non-Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 10 | C | 546 | 0 | 0 | 0 | 0 | 0 | 7.8 | 8.7 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 10 | P | 125 | 0 | 0 | 0 | 0 | 0 | 0.9 | 1.35 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 12.5 | C | 18 | 0 | 0 | 0 | 0 | 0 | 6.1 | 7 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 12.5 | P | 16 | 0 | 0 | 0 | 0 | 0 | 1.55 | 2.05 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 15 | C | 106 | 0 | 0 | 0 | 0 | 0 | 5 | 5.5 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 15 | P | 219 | 0 | 0 | 0 | 0 | 0 | 2.45 | 3 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 17.5 | C | 33 | 0 | 0 | 0 | 0 | 0 | 3.5 | 4.2 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 17.5 | P | 34 | 0 | 0 | 0 | 0 | 0 | 3.6 | 4.4 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 20 | C | 65 | 0 | 0 | 0 | 0 | 0 | 2.65 | 3.4 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 20 | P | 0 | 0 | 0 | 0 | 0 | 0 | 5.2 | 6 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 22.5 | C | 111 | 0 | 0 | 0 | 0 | 0 | 1.85 | 2.6 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 22.5 | P | 20 | 0 | 0 | 0 | 0 | 0 | 6.9 | 7.7 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 25 | C | 45 | 0 | 0 | 0 | 0 | 0 | 1.5 | 2 | 16.88 | Leap | Equity |
| 20080215 | NITE | YTI | 20100116 | 25 | P | 0 | 0 | 0 | 0 | 0 | 0 | 8.7 | 9.6 | 16.88 | Leap | Equity |

Exhibit III shows the discounts on February 15, 2008 for the thirteen brokerage companies that have LEAPS. The expiration date of the 2010 LEAPS, January 16, is about 23 months after our valuation date, February 15, 2008. The January 17 expiration date for 2009 LEAPS is 11 months after our valuation date. Some general observations can be drawn from this data. The cost of LEAPS for even the largest companies in the industry like Goldman Sachs, Morgan Stanley and Merrill Lynch is 20% or more. The cost at the 75th percentile is 25%.

Step 5: Analyze The Data To Determine A Reasonable Benchmark Discount

You can analyze the data in the same way you would analyze the data for a publicly traded guideline company. One (of several) ways to do so is to use a chart like Exhibit IV, which utilizes data from the spreadsheet you downloaded from Yahoo Finance. The object of this analysis is to determine a reasonable benchmark range of discounts for your subject company. For example, our research on the entire universe of LEAPS³ shows that discounts (or costs of price protection) increase significantly as company size decreases or as risk increases. These characteristics are obvious in the 44.6% discount of E*Trade Financial (ETFC) and the 43.4% discount of Friedman Billings Ramsey (FBR), both of which had financial difficulties in 2007. Yet these companies are hundreds of times larger in revenues or assets than the company we are valuing. The three companies whose operations are most similar to our subject's are Schwab (SCHW) at 20.9% discount, TDAmeritrade (AMTD) at 20.8%, and E*Trade at 44.6%. The five companies with 2007 revenues under \$2 billion have discounts ranging from 21.2% to 44.6%. Considering the very small size of our subject company, it is hard to imagine anyone arguing for

³ Seaman, Ronald M., "Annual Studies," www.dlom-info.com.

Exhibit III
Step 4
Public Brokerage Companies With LEAPS
Cost of Price Protection, as of Feb. 15, 2008

| Description | Symbol | Stock Price | Jan.'09 LEAPS | | | | Jan.'10 LEAPS | | | |
|---------------------------|--------|-------------|---------------|---------|-------------------|------------------|---------------|---------|-------------------|------------------|
| | | | Strike Price | Cost | Dist. Wghtd. Cost | Discount/ Cost % | Strike Price | Cost | Dist. Wghtd. Cost | Discount/ Cost % |
| Charles Schwab Corp. | SCHW | \$20.05 | \$20.00 | \$3.00 | Not Applic. | 15.0% | \$20.00 | \$4.20 | Not Applic. | 20.9% |
| E*TRADE Financial Corp. | ETFC | \$5.13 | \$5.00 | \$1.65 | | | \$5.00 | \$2.20 | | |
| | | | \$7.50 | \$3.40 | \$1.74 | 33.9% | \$7.50 | \$4.00 | \$2.29 | 44.6% |
| Goldman Sachs Group | GS | \$175.54 | \$175.00 | \$25.60 | Not Applic. | 14.6% | \$170.00 | \$32.10 | | |
| | | | | | | | \$180.00 | \$37.10 | \$34.87 | 19.9% |
| Lehman Brothers Holdings | LEH | \$54.10 | \$50.00 | \$8.10 | | | \$50.00 | \$11.20 | | |
| | | | \$55.00 | \$10.40 | \$9.99 | 18.5% | \$60.00 | \$16.30 | \$13.29 | 24.6% |
| Merrill Lynch & Co., Inc. | MER | \$50.90 | \$50.00 | \$8.40 | | | \$50.00 | \$11.40 | | |
| | | | \$55.00 | \$11.00 | \$8.87 | 17.4% | \$55.00 | \$14.10 | \$11.89 | 23.4% |
| Morgan Stanley | MS | \$42.36 | \$40.00 | \$6.00 | | | \$40.00 | \$8.20 | | |
| | | | \$45.00 | \$8.50 | \$7.18 | 16.9% | \$45.00 | \$10.80 | \$9.42 | 22.2% |
| optionsXpress Holdings | OXPS | \$25.31 | \$25.00 | \$3.90 | | | \$25.00 | \$5.20 | | |
| | | | \$27.50 | \$5.40 | \$4.08 | 16.1% | \$27.50 | \$6.50 | \$5.36 | 21.2% |
| SEI Investments Co. | SEIC | \$25.35 | \$25.00 | \$3.50 | | | \$25.00 | \$6.90 | | |
| | | | \$30.00 | \$6.80 | \$3.73 | 14.7% | \$30.00 | \$9.40 | \$7.08 | 27.9% |
| TD AMERITRADE Corp. | AMTD | \$18.02 | \$17.50 | \$2.25 | | | \$15.00 | \$2.30 | | |
| | | | \$20.00 | \$3.70 | \$2.55 | 14.2% | \$20.00 | \$4.70 | \$3.74 | 20.8% |
| Bear Stearns Co. | BSC | \$82.47 | \$80.00 | \$12.90 | | | \$80.00 | \$16.40 | | |
| | | | \$85.00 | \$15.30 | \$14.08 | 17.1% | \$90.00 | \$20.90 | \$17.53 | 21.3% |
| Friedman Billings Ramsey | FBR | \$2.97 | \$2.50 | \$0.75 | | | \$2.50 | \$0.95 | | |
| | | | \$5.00 | \$2.40 | \$1.06 | 35.7% | \$5.00 | \$2.75 | \$1.29 | 43.4% |
| Knight Capital Group Inc. | NITE | \$16.88 | \$15.00 | \$2.05 | | | \$15.00 | \$3.00 | | |
| | | | \$17.50 | \$3.20 | \$2.91 | 17.2% | \$17.50 | \$4.40 | \$4.05 | 24.0% |
| Legg Mason Inc. | LM | \$69.04 | \$60.00 | \$5.50 | | | \$60.00 | \$8.60 | | |
| | | | \$70.00 | \$9.70 | \$9.28 | 13.4% | \$70.00 | \$13.00 | \$12.56 | 18.2% |
| Median | | | | | | 16.9% | | | | 22.2% |
| 25th Percentile | | | | | | 14.7% | | | | 20.9% |
| 75th Percentile | | | | | | 17.4% | | | | 24.6% |

a discount for our subject lower than 25%, the 75th percentile of all 13 companies. This sets an important lower limit for our discount conclusion.

Comparing our subject to the public companies, we can see a strength in that the subject has no debt and has a return on equity somewhat better than the average “Investment Brokerage – Regional.” However, its profit margin percentage, 4.0%, is before taxes and still is less than half the margin of the public companies (which report after tax profits). Still, the subject does not have financial problems of the magnitude of ETFC or FBR. Consequently, an upper limit for a discount is probably around 40%.

The argument will be made, of course, that none of these companies is precisely comparable to our subject. Generally that will be true. But, our objective is not to determine an exact discount but to set a reasonable and defensible minimum level or benchmark discount. Moreover, this minimum discount is industry specific and valuation date specific.

Step 6: Reach A Final Discount Conclusion With The Use Of A Mandelbaum Construct

In arriving at a conclusion, we have found useful the chart on the following page which examines the Mandelbaum case factors and ranks their influence relative to the public companies that have LEAPS. In this regard, it is important to keep in mind the factors that are already included in the public company group, such as (in general) small, non-influential share holdings, industry-specific risk, holding period (11 months for 2009 LEAPS or 23 months for 2010 LEAPS), and

Exhibit IV

Step 5: Analysis of Public Companies With LEAPSLatest Fiscal Yearends

(dollars in millions)

| <u>Description</u> | <u>Symbol</u> | <u>Total Revenues</u> | <u>Total Assets</u> | <u>Ratio</u> | | <u>ROE %</u> | <u>Div. Yield %</u> | <u>Debt to Equity</u> | <u>Price to Book</u> | <u>Net Profit Margin</u> | <u>Operations (a)</u> |
|-----------------------------|---------------|-----------------------|---------------------|-------------------------|------------|--------------|---------------------|-----------------------|----------------------|--------------------------|-----------------------|
| | | | | <u>Revenues/ Assets</u> | <u>P/E</u> | | | | | | |
| Investm't Brokerage - Natl. | | | | | 11.5 | 18.3 | 1.3 | 12.0 | 2.2 | 8.9 | |
| Investm't Brokerage - Regl. | | | | | 27.9 | 7.7 | 1.3 | 0.8 | 9.1 | 10.8 | |
| Charles Schwab Corp. | SCHW | \$4,994.0 | \$42,286.0 | 0.12 | 10.0 | 26.7 | 1.0 | 0.2 | 6.7 | 22.9 | 1 |
| E*TRADE Financial Corp. | ETFC | -\$378.0 | \$56,845.9 | N.M. | NA | -41.0 | NA | 6.9 | 0.8 | NA | 1 |
| Goldman Sachs Group | GS | \$45,987.0 | | | 7.6 | 29.5 | 0.7 | 10.2 | 1.8 | 29.9 | 3 |
| Lehman Brothers | LEH | \$19,257.0 | \$691,063.0 | 0.03 | 8.3 | 20.1 | 1.1 | 18.2 | 1.5 | 20.2 | 3 |
| Merrill Lynch | MER | \$11,250.0 | \$1,020,050.0 | 0.01 | NA | -22.2 | 2.6 | 16.6 | 1.3 | NA | 3 |
| Morgan Stanley | MS | \$28,026.0 | \$1,045,409.0 | 0.03 | 14.5 | 7.7 | 2.4 | 16.8 | 1.5 | NA | 3 |
| optionsXpress | OXPS | \$247.0 | \$1,155.5 | 0.21 | 16.2 | 42.6 | 1.0 | NA | 5.7 | 40.7 | 2 |
| SEI Investments Co. | SEIC | \$1,369.0 | \$1,252.4 | 1.09 | 20.4 | 37.5 | 0.5 | 0.1 | 6.7 | 15.2 | 3 |
| TD AMERITRADE | AMTD | \$2,283.4 | \$18,859.2 | 0.12 | 14.6 | 35.8 | 0.0 | 0.6 | 4.4 | 39.1 | 1 |
| Bear Stearns Companies | BSC | \$5,945.0 | \$395,362.0 | 0.02 | 53.0 | 1.9 | 1.5 | 19.5 | 1.0 | NA | 3 |
| Friedman Billings Ramsey | FBR | \$105.5 | \$2,469.5 | 0.04 | NA | -41.5 | 5.9 | 5.8 | 0.8 | NA | 3 |
| Knight Capital Group Inc. | NITE | \$669.1 | \$1,755.8 | 0.38 | 13.4 | 13.4 | NA | 0.1 | 1.7 | 19.3 | 3 |
| Legg Mason Inc. | LM | \$4,343.7 | \$9,604.5 | 0.45 | 14.6 | NA | 1.3 | 0.1 | 1.4 | 13.0 | 2 |
| Subject Company | | \$9.8 | \$4.4 | 2.23 | | 11.7 | | 0.0 | | 4.0 (b) | |

(a) Similarity of operations to subject:

Criterion: Primary business is financial services to individuals.

1 = most similar to subject

2 = some similarities to subject

3 = least similar to subject

(b) Earnings before tax (S-corp.)

market conditions on the valuation date. Then, you can weigh each factor and determine a discount conclusion for your company's specific characteristics.

A Mandelbaum construct also helps to remind us of factors not embedded in any of the LEAPS, such as restrictions on transfers of shares, likely cost of a public offering, an influential-size shareholding, an unusual cash distribution policy, or others.

Exhibit V compares our subject company to the industry group of 13 companies that have publicly traded LEAPS. It helps crystallize the factors contributing to a marketability discount conclusion. Several factors require a discount conclusion higher than our 25% base: 1) company specifics like its small size, small market, small line of products and services; 2) lack of management depth; 3) the Company's right of first refusal on transfers; and 4) a redemption price lower than fair market value. The key offsetting factor is a short holding period provided by the Company's redemption policy. Overall it would be reasonable to conclude a discount for lack of marketability of 35% for our subject.

Conclusion

Although LEAPS do not provide a DLOM "answer," it is clear that by using them we can prove a base discount (for companies with comparable characteristics) and make defensible estimates of upper and lower ranges of discount. In this way, the analysis of LEAPS provides much better substantiation of the discount conclusion.

Exhibit V
Step 6: Mandelbaum DLOM Factors
Compared To Public Company Peer Group

| <u>Factor</u> | <u>Comparison</u> | <u>Effect On DLOM</u> | <u>Weight In Conclusion</u> |
|---|---|-----------------------|-----------------------------|
| <u>Financial Statement Analysis</u> debt/equity ratio; profitability; growth; stability; risk | <ul style="list-style-type: none"> - Strong balance sheet - Low profitability but long history of profitability - Growth comparable to industry | Neutral | 30% |
| <u>Dividend/Distribution Policy</u> size; consistency; growth | <ul style="list-style-type: none"> - Comparable to industry | None | 0% |
| <u>Company/Industry</u> size; position in industry; history; economic outlook | <ul style="list-style-type: none"> - Very small in size. Non-influential. - Small geographic market - No significant products or services other than brokerage | Increases | 30% |
| <u>Company Management</u> experience; depth | <ul style="list-style-type: none"> - Experienced management but little depth. | Increases | 10% |
| <u>Amount of Control In Transferred Shares</u> | <ul style="list-style-type: none"> - None. Comparable to public companies. | None | 0% |
| <u>Restrictions On Transfer</u> | <ul style="list-style-type: none"> - Company has right of first refusal on transfers to other than current shareholders and their families. | Increases | 10% |
| <u>Anticipated Holding Period</u> | <ul style="list-style-type: none"> - 1 to 2 years. Comparable to LEAPS. | None | 0% |
| <u>Company Redemption Policy</u> policy; financial capability; History | <ul style="list-style-type: none"> - Company redeems "small amounts" of shares annually for cash (at Company discretion). - Redemption price is adjusted book value, which is lower than fair market value. | Neutral | 20% |

likely Cost of Public Offering

legal ability? financial ability
to afford cost?

- Public offering unlikely. Cost high.

None

0%