USPAP Sanctions Use of QMDM?

“Although often misunderstood as some kind of proprietary black box, the QMDM is simply a shareholder level discounted cash flow model...”

Does the new USPAP sanction the use of the Quantitative Marketability Discount Model? Not exactly. But among the more interesting aspects of the revised Uniform Standards of Appraisal Practice, which is scheduled to go into effect on July 1 of this year, deals with the issue of marketability.

For the first time, USPAP will now require consideration of the “extent to which the interest is marketable and/or liquid” (Standards Rule 9-2.e.v). The revisions to this element of the standard goes on in Rule 9-4(d) to state “an appraiser must, when necessary for credible assignment results, analyze the effect on value, if any, of the extent to which the interest appraised contains elements of ownership control and is marketable and/or liquid” [emphasis added].

In a comment to this section, it states “an appraiser must analyze factors such as holding period, interim benefits, and the difficulty and cost of marketing the subject interest.”

Twelve years ago we introduced the Quantitative Marketability Discount Model, or QMDM, as a methodology that would assess the cost of liquidity on the basis of facts and circumstances that were specific to a subject interest. We believed this was a big improvement on the then-standard methodology of relying on irrelevant and often obscure data to impute the same discount for every business interest regardless of reality.

Although often misunderstood as some kind of proprietary black box, the QMDM is simply a shareholder-level discounted cash flow model (DCF) that looks at five factors:

1. The expected growth in value of the subject interest (necessary to generate a terminal value for the DCF).
2. The expected interim benefits from the subject interest (dividends or distributions during the expected holding period).
3. The expected growth in the expected interim benefits during the expected holding period.
4. The shareholder level required holding period return (not surprisingly a premium return to that which would be expected for the enterprise on a marketable basis).
5. The expected holding period for the subject interest (you can’t have a DCF without some specific term).
The appraisal community includes plenty of smart and creative people and no doubt there is another way out there to satisfy USPAP without the QMDM, but at least we know where we stand. We’ve written books and articles, given dozens of speeches, and have successfully used the QMDM thousands of times over the last twelve years.

No Nobel Prize in economics yet, but much of the appraisal community has come around to the concept of rate of return based models for determining marketability discounts; the rest of you have until July 1st.

As for the pre-IPO and restricted stock studies, they’ve had more comebacks than Martha Stewart. It’s going to be tough to slice and dice that data such that it considers holding period and interim benefits, but we have faith that someone out there is working on it, feverishly. Bon chance!

As for the pre-IPO and restricted stock studies, they’ve had more comebacks than Martha Stewart. “As for the pre-IPO and restricted stock studies, they’ve had more comebacks than Martha Stewart.”

Matthew R. Crow, CFA, ASA croum@mercercapital.com

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Much has been written and said about the Quantitative Marketability Discount Model (QMDM) – some of it positive, and some not. While some may think of it as a proprietary “black box,” we contend that the QMDM is simply a shareholder-level discounted cash flow model (DCF).

In this webinar, Chris Mercer will demystify the QMDM and give you tools to understand, use, and defend the QMDM.

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Rule 9-4(d) of the 2006 USPAP Standards (effective July 1st) states: “an appraiser must, when necessary for credible assignment results, analyze the effect on value, if any, of the extent to which the interest appraised contains elements of ownership control and is marketable and/or liquid.” In a comment to this section, it states “an appraiser must analyze factors such as holding period, interim benefits, and the difficulty and cost of marketing the subject interest.”

To our knowledge, the QMDM is the only tool available to you to comply with this new standard. In this webinar, Chris Mercer will demystify the QMDM and give you tools to understand, use, and defend it.

After this webinar, you will know:

» The theoretical foundations of the QMDM
» What the QMDM does, why it works, and how it has been used successfully
» How to develop each of the assumptions of the QMDM, discussing the underlying facts, circumstances and market data that are used to support the reasonableness of the assumptions
» How to counter assertions that the QMDM has been rejected by the courts

We’ll also illustrate the use of the QMDM in specific examples and answer questions. Don’t miss this one-time-only event!
The QMDM to be Discussed and Debated in a Teleseminar on May 30th

The three most widely used methods to determine discounts for lack of marketability are the use of restricted stock studies, the use of Pre-IPO studies, and the QMDM. In this teleconference, scheduled for Tuesday, May 30th, three leading experts, Espen Robak, Brian Pearson, and Chris Mercer, who are staunch defenders of their approaches, will enter into a debate on the merits of each method. Lance Hall will act as a partial moderator.

This presentation will give equal time to each of the proponents to give the listener a greater understanding of: the strengths of the weaknesses of each method, how to respond to court "rejections," and how to respond to criticisms of each method. A case study will also be featured.

If you are looking for a lively debate on the topic of determining marketability discounts, register for this teleseminar today by visiting BV Resources website at www.bvresources.com.

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May 30, 2006
“Marketability Discounts - The Debate Continues”
Teleseminar Sponsored by Business Valuation Resources
Z. Christopher Mercer, ASA, CFA
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June 1, 2006
“Buy - Sell Agreements: Ticking Time-Bomb or Reasonable Resolution?”
NACVA’s Annual Conference
   San Francisco, California
Z. Christopher Mercer, ASA, CFA

June 13, 2006
“The QMDM: A Shareholder-Level DCF
   How to Understand, Use, & Defend It”
Webinar sponsored by Mercer Capital
Z. Christopher Mercer, ASA, CFA
(See page 3 for registration information)

June 15, 2006
“The Basics of Business Valuation”
Business Law Institute
   St. Louis, Missouri
Z. Christopher Mercer, ASA, CFA

August 21, 2006
CPA Associates
   Philadelphia, Pennsylvania
“Buy - Sell Agreements: Ticking Time-Bomb or Reasonable Resolution?”
Matthew R. Crow, ASA, CFA
   “FAS 141 Issues”
Travis W. Harms, CPA/ABV, CFA

September 18, 2006
“Buy - Sell Agreements: Ticking Time-Bomb or Reasonable Resolution?”
Virginia Society of CPA’s 7th Annual Business Valuation,
   Fraud and Litigation Services Conference
   Richmond, Virginia
Z. Christopher Mercer, ASA, CFA

October 19-20, 2006
“Today’s Word on Lack of Marketability”
CICBV/ASA Annual Conference
   Toronto, Canada
Z. Christopher Mercer, ASA, CFA

November 6, 2006
“Marketing with the Newest Technology Tools”
IGAF Conference
   Las Vegas, Nevada
Barbara Walters Price

December 3, 2006
“Buy - Sell Agreements: Ticking Time-Bomb or Reasonable Resolution?”
AICPA Business Valuation Conference
   Austin, Texas
Z. Christopher Mercer, ASA, CFA

December 4, 2006
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