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Kevin Yeanoplos, ASA, CPA/ABV is the Director of Valuation Services for Brueggeman and Johnson Yeanoplos, P.C., a firm that specializes in the areas of business and intellectual property valuation. Over the last four decades, Kevin has assisted a national client base with the valuation of a diverse array of intangibles including patents, trademarks and song catalogs to name a few.

As an expert witness or court appointed neutral in state and Federal courts across the country, Kevin has assisted triers of fact in understanding a variety of complex valuation issues. Kevin frequently lectures throughout the United States on the topics of valuation, applied finance and financial analysis, including presentations to the FBI, AICPA and many other professional organizations.

When he's not chasing down the value of the invaluable, you can find the AICPA BV Hall of Fame Member running around the country on a 200 mile Ragnar Relay, using his business acumen as a board member for a local theatre or radio station, educating the public about the wonders of nature as a Board Member for Audubon Rockies, advocating for royalty reform as a member of the National Academy of Recording Arts and Sciences or interviewing the likes of Roger Daltrey, John Oates and Brian Wilson as a Beat Writer for AXS Entertainment and the webzine that he recently founded, *Trebled Minds*.

Ronald L. Seigneur, ASA, CPA/ABV, CVA



Ron is a partner in Seigneur Gustafson LLP, a CPA and consulting firm located in Lakewood, Colorado. Ron is a Senior Appraiser in Business Valuation from the American Society of Appraisers (ASA). He also holds the AICPA specialty designation of Accredited in Business Valuation (ABV) and is a Certified Valuation Analyst (CVA) with the National Association of Certified Valuators and Analysts. He has published over 100 articles on business valuation, economic damages, leadership, compensation systems and related practice management subjects. Ron has taught a number of intermediate and advanced seminars and courses for state Bar Associations and law firms; and has successfully facilitated over 100 law firm retreats and planning meetings. Ron is a past Chair of the Colorado Society of CPAs and is Chair of the Business Valuation Committee of the American Society of Appraisers.

Ron has been qualified and provided testimony as an expert witness in several jurisdictions on a wide range of issues ranging from complex business valuations, forensic investigations, and various forms of economic damages. Ron has served appointments as trustee, mediator, arbitrator, special master of the court, as well as serving as an expert for the Colorado State Board of Accountancy and Colorado Attorney General. Ron was inducted into the AICPA Business Valuation Hall of Fame in 2006 and is a Fellow in the College of Law Practice Management. Ron is a charter member of the AAML Foundation's Business Valuation and Forensics Division.

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ACKNOWLEDGEMENT

Thanks to almost the entire universe of valuation professionals for allowing us to use some content from a prior presentations on this topic

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Note on the Presentation

It is our normal practice to provide as much material as we can for the attendees. As a result, we might not cover every slide included in the presentation. If the slides we do not cover raise questions in your mind, please feel free to either contact us after the presentation or send us an email and we will be sure to answer your question.

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In the beginning....

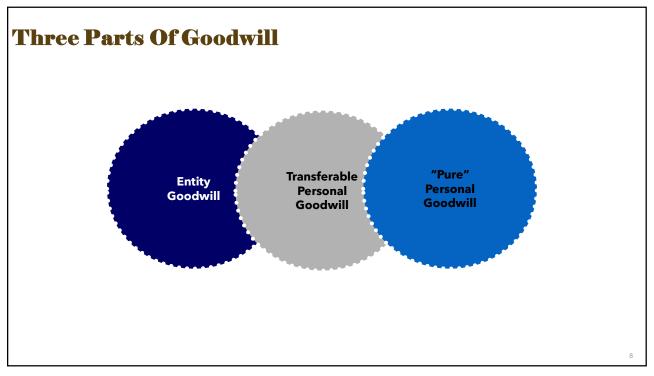
"Goodwill is the probability that customers will return to the old stand."

• <u>Cromwell v. Lye</u>, 34 England Reporter, 129, 134 (**1810**)

"Goodwill is the tendency for customers to return to the same location or company because of its name or other reasons, regardless of its location."

• In re Brown, 242 N.Y. 1, 6, 150 N.E. 581, 582 (1926)

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Entity Goodwill

That which belongs strictly to the entity itself.

Examples include:

- Name
- Phone number
- Website / social media
- Location
- Contracts (e.g., Anesthesiologist group contract with a hospital)
- Special Attributes (e.g., special menu items or recipes at a restaurant)
- Assembled work force (but is that Goodwill?)
- Going concern value (but is that Goodwill and is assembled workforce part of a going concern value?)

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"Pure" Personal Goodwill

- That Goodwill which cannot be transferred to the entity or to anyone else under any circumstance. These are usually true personal type relationships:
 - "We want Harold to testify in this case because we know what type of a witness he is. No one else will do."
 - "Shirley has been our family business advisor for twenty-five years. Only she can give us the comfort level we need in an outside consultant."
 - "Wayne has developed the cultural relationship and ties necessary to gain the trust of Mr. Chin. Therefore, only Wayne is able to buy and sell tungsten powder and scrap with Mr. Chin."

Transferable Personal Goodwill

•That Goodwill which is personal in nature but can or might be transferred to either the subject entity, another entity, or to another person.

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Transferable Personal Goodwill (contd.)

- These can be personal relationships that CAN be transferred or specialized knowledge that can be transferred through training or development of other persons.
- This could also include items such as contact lists that have been developed over a period of time or client or patient relationships that can be transferred.



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PROPERTY IN DISSOLUTION CASES

- Marital/Non-Marital/Separate
 - ✓ <u>Marital</u>: Presumption that all property either spouse acquired during the marriage is marital
 - ✓ <u>Separate</u>: A spouse's asset or debt/liability acquired prior to the marriage

OR

- ✓ Specific Statutory or Caselaw Exclusion:
 - ➤ Inheritances or gifts
 - ➤ In exchange for premarital property or by gift or inheritance
 - > Property excluded by marital agreement
 - > Property acquired after entry of decree of legal separation

PROPERTY IN DISSOLUTION CASES - Cont'd

- Tangible/Intangible
 - ✓ Tangible:
 - > Physical property (cash, real estate, vehicles, accounts, receivables)
 - ✓ Intangible:
 - > Rights, benefits, intellectual property, business/personal goodwill

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PROPERTY IN DISSOLUTION CASES - Cont'd

- Classification Challenges for Marital Property
 - √ Educational Degrees: Not property
 - > Lack exchangeable and objectively transferable value
 - ➤ Mere expectancy for enhanced income obtained from college or professional degree
 - ➤ Specific benefit only for degree-holder
 - √ Vested legal rights to obtain benefit, value, income: Property
 - ➤ Benefits under retirement plans, stock option plans, trusts, and other contractual arrangements represent ownership interests in property
 - √ Lack of vested contractual rights/immediate right to possession: Not Property

BUSINESS AND PROFESSIONAL GOODWILL: DEFINITIONS

- Definition of Goodwill
 - ✓ <u>Legal/Conceptual</u>: a business's capacity to generate repeat business from its customers ➤ Includes attracting new customers AND
 - > Expanding volume and/or value of business from existing customers
 - ✓ <u>Accounting/Operational</u>: a business's returns that exceed the normal rate of return for its identifiable tangible and intangible assets used in that business
- Use of both definitions in valuing businesses and the personal/professional goodwill of persons engaged in the business or profession
- Types of Goodwill
 - √ Business or Enterprise
 - ✓ Personal or Professional

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CHARACTERISTICS OF GOODWILL

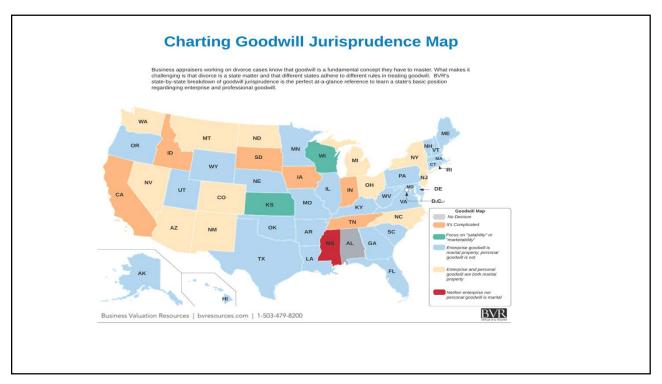
- ✓ Associated with or generated by a business or professional practice
- √ Transferable or portable
- √ Represents intangible value of business or practice above fixed assets and receivables

DEFINING AND DESCRIBING GOODWILL

- Challenges in the Conceptual/Legal Definition of Goodwill
 - ✓ Definition of a "business"
 - > A person doing business OR
 - > Entity other than a natural person
 - ✓ Property must be transferable or capable of being transferred
 - "Elite professional standing" cannot be transferred
 - Personal characteristic of individual
 - Therefore, not "property" because not transferable
 - Only a business can have expectation of continued public patronage
 - > "Business" is not earning capacity or professional reputation

Source: In re Marriage of McTiernan & Dubrow (133 Cal. Rptr.3d 287, 2005) (Majority, concurring, and concurring-and-dissenting opinions)

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WHERE NO GOODWILL – BUSINESS OR PERSONAL – IS MARITAL PROPERTY

- Minority Approach : Fewer than Six States
 - √ Goodwill has no independent economic or legal existence except as it attaches to a property or right
 - ✓ Attaches to a professional as confidence, trust, and reputation
 - ✓ Justified because of difficulty in valuing goodwill
 - √ Cannot be separately sold or pledged
 - ✓ Can lead to inequitable results for non-professional spouse
 - ✓ Personal/Professional Goodwill = Probability of substantial future earnings
 - Extinction of personal goodwill with death, retirement of the professional
 - ✓ Difficulty of measuring personal/professional goodwill
- Consequences
 - √ With goodwill comprising most of the value in a professional practice, the non-professional spouse may lose substantial accumulated equity in the business/practice
 - √ Spousal support/maintenance an inadequate substitute for this policy

Sources: Powell v. Powell, 231 Kan. 456 (1982) and Nail v. Nail, 486 S.W. 2d 761 (Tex. 1972)

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WHERE ALL GOODWILL IS MARITAL PROPERTY

Approximately a third of states take this approach

- Justifications
 - $\checkmark \ \ \text{Non-professional spouse entitled to compensation for contributions to successful business}$
 - ✓ Professional practices have goodwill an expectation of repeat business just like traditional businesses
 - ✓ Professional practice will continue post-decree with intangible goodwill value
 - √ Goodwill survives the practicing professional
- Consequences
 - √ Potential double-counting/double-dipping hazards
 - ✓ Difficulty/Disagreement over valid, proper measurement of personal goodwill

WHERE BUSINESS GOODWILL IS MARITAL PROPERTY, BUT PROFESSIONAL GOODWILL IS NOT

Majority position among states

- Justification
 - · Basic Principle: Goodwill is only a personal asset of the practicing professional
 - · Represents future earning capacity used for support determinations
 - · Not salable, marketable, transferable
 - · Difficult to separately measure personal/professional goodwill through available methods
 - No existence for personal goodwill apart from the business to which it is attached and from the
 professional spouse whose reputation generates the goodwill
- Consequences
 - Deprives non-professional spouse of valuable asset acquired during the marriage
 - Proof of personal goodwill must be demonstrated as separate and distinct from reputation of professional spouse
 - Increasing challenges to valuation experts establishing the separateness and measurability of personal goodwill

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FLORIDA: EVIDENCE AND METHODOLOGY MATTER

- Thompson (576 S.2d 267):
 - Personal goodwill only represents future earnings of professional spouse, therefore not a marital asset
 - Business/enterprise goodwill value must be independent of personal goodwill of professional spouse
 - Fair market value is the legal standard for business valuation in Florida, established by evidence of:
 - √ Comparable sales, but not required
 - √ As long as there is a reasonable basis for expert's opinions

FLORIDA: EVIDENCE AND METHODOLOGY MATTER – Cont'd

- Cases Where Expert Opinion Rejected as Unreliable
 - · Young (600 So.2d 1140): Ob-Gyn: Experts used rule of thumb and excess earnings methods for valuation
 - Rejected valuation for failure to separate personal and business goodwill from valuation
 Failure to use fair market value, which would separate personal from business goodwill
 - · Weinstock (634 So.2d 57): Dentist: Wife's expert used sales of Florida dental practices in prior two years
 - ✓ Rejected valuation because selling professional remained with practice after sale
 - ✓ Comparable practice sales data invalid because goodwill of practice not separated from continued presence of selling dentist and his personal goodwill
 - Walton (657 So.2d 1214): Sole proprietor CPA: Expert valuation based on fixed assets only (H) and excess earnings (W)
 - Rejected both valuations because no comparable sales and no sale would occur without non-compete agreement
 - ✓ No competent evidence of business goodwill separate from professional spouse's reputation
 - Williams (667 So.2d 915): Sole proprietor accountant: Rejected valuation for lack of evidence of business goodwill separate from the professional reputation and continued presence of the professional spouse in the business
 - Held (912 So.2d 637): Insurance agency: Valuations predicated on seller-husband's continued involvement in business OR
 presence of non-compete agreement for comparable sales data employed
 - King (Fla. App. Case No. 1D19-3280, March 4, 2021): Insurance agency: valuation experts used Deal Stats data for comparable
 agency sales.
 - ✓ Data on comparable sales inapplicable because all agency sales occurred outside Florida
 - ✓ Not only no recent sales of similarly-situated agencies, no effort to determine whether selling professional remained with agency after sale, and no separation of personal from business goodwill

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FLORIDA: EVIDENCE AND METHODOLOGY MATTER – Cont'd

√ Cases Where Expert Valuation Opinions Accepted

- Christians (732 So.2d 47): Construction and servicing of flying trapeze equipment
 - Expert opinions on business valuation accepted because record evidence demonstrated that any business goodwill solely the result of husband's reputation and abilities and his continued involvement in the business
 - > Thus, the only business goodwill was personal goodwill, with all goodwill excluded from valuation
- Hough (793 So.2d 57): Vending machine business; three experts disputed extent of husband's involvement in business
 - Court affirmed trial court based on cited record evidence supporting husband's expert's assumptions about husband's continued involvement in business and resulting personal goodwill

CALIFORNIA: IT'S COMPLICATED

- · Key Elements of California Goodwill Law
 - · Professional practice and its goodwill automatically goes to the licensed professional (Lopez)
 - Value of professional goodwill derived from individual's "energy, skill, judgment, intelligence, and personality" (Lopez)
 - Value of professional practice based on value of:
 - ✓ Fixed assets (cash, furniture, equipment, supplies, professional resources
 - √ Other assets (aged accounts receivable, costs advanced, work in progress, work completed but not billed)
 - √ Goodwill of the practitioner as a going-concern
 - √ Liabilities of the professional practitioner (Lopez)
 - Employment agreements and other agreements unrelated to the marriage dissolution are not binding on the valuation of assets or goodwill (Slater)

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CALIFORNIA: IT'S COMPLICATED - Cont'd

- Expected future earnings are not the measure or definition of the goodwill of a professional practice (Slater)
- · Non-professional spouse viewed as a "withdrawing silent partner" for the professional practice (Brawman, Golden)
 - ✓ Entitled to fair compensation for her or his share of the business
 - √ Other spouse made contributions to "earnings and accumulations" of the professional practice
 - √ Professional practice will not be dissolved and continues with same value for practicing professional
- Property practicing professional receives upon withdrawal from the practice does not control property division in dissolution (Fenton)
 - ✓ Marital value is "community value" of professional practice as going-concern on date of decree
 - ✓ Non-professional's interest in professional business "as if it were the increased value of stock in a family business"
 - ✓ Professional goodwill cannot be eliminated by recitals in corporate documents
- Even if value of interest in law firm controlled by attorney's employment agreement or stock purchase agreement, and
 no share of the firm's enterprise goodwill, individual attorney may possess personal goodwill based on the earnings of
 his or her individual practice
 - √ Applying excess earnings method
- · Comparing revenues from professional spouse's practice compared to peers in similar firms, practices (Iredale & Cates)

CALIFORNIA: IT'S COMPLICATED – Cont'd Trouble in Paradise (McTiernan & Dubrow)

- > Legal requirements for professional goodwill
 - · Definition of "business"
 - ✓ Person "doing business" OR
 - ✓ A professional, commercial, or industrial enterprise
 - · Only the second definition applies
 - ✓ No statutory reference to "natural persons" in defining "business"
 - ✓ "Goodwill" is only an incident to a going-concern enterprise organized as a "business"
 - · Goodwill limitations and characteristics
 - ✓ Cannot be transferred or sold independently
 - $\checkmark\quad \mbox{Separate from the person(s)}$ who operate, own, or manage the business
- Goodwill and business
 - · "Business" is not a "natural person"
 - · If no distinction between "business" and "person doing business," then actors, artists, athletes, musicians would have business goodwill
 - · Economically, goodwill is based on earnings of the business"
 - · Property, including marital property, must be capable of being transferred (e.g., sold, pledged)
 - Problem of creating liability for goodwill, personal or business, without earnings to pay the liability
 - No value on market for "something that cannot be transferred or sold"

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CALIFORNIA: IT'S COMPLICATED – Cont'd Trouble in Paradise (*McTiernan & Dubrow*)

- Distinction between "occupation" and "business"
 - "Occupation" cannot be a "business" because cannot expand beyond individual "in whom the talent resides"
 - No ability to replace the individual performing that "occupation"
 - · Therefore, an "occupation" cannot be "a business"
- > Professional/personal goodwill cannot exist in absence of a business or professional practice
 - · Practices are transferable because bought and sold
 - Marital property goodwill exists only in a business or professional practice
 - √ The form of the professional practice does not control the legal analysis
 - \checkmark Value of goodwill attaches to the professional spouse's practice
 - $\checkmark \ \ \text{Cannot eliminate professional goodwill in an employment agreement or stock purchase agreement}$
 - Professional goodwill may attach to and continue with a business or professional practice even after the separation of the individual upon whom it was founded.

EVOLUTION OF PERSONAL GOODWILL: THE CASE OF WISCONSIN

- Holbrook v. Holbrook, 309 N.W.2d 343 (Wis. App. 1981)
 - Goodwill has no existence apart from the business to which it attaches and can be determined only upon actual sale of business
 - But no market determination in judicially-ordered sale in dissolution case
 - · Rejecting concept of professional goodwill as a divisible marital asset in Wisconsin
 - Professional goodwill indistinguishable from future earning capacity of the professional spouse
 - Professional business's good reputation does not bestow on business owners an actual separate property interest
 - Professional goodwill is not salable and has value only to its holder in terms of increased future earnings
 - "Disturbing inequity in compelling a professional practitioner to pay a spouse a share
 of intangible assets at a judicially determined value that could not be realized by a sale
 or another method of liquidating value"

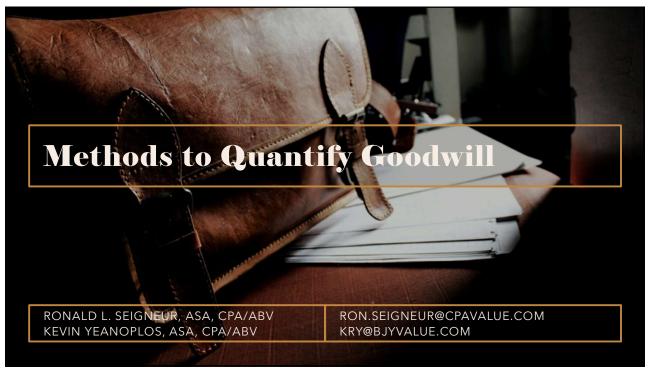
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EVOLUTION OF PERSONAL GOODWILL: THE CASE OF WISCONSIN – Cont'd

- In re Marriage of McReath, 800 N.W.2d 399 (Wis. 2011)
 - Property valued for the division of the marital estate should be valued at fair market value
 - Dissolution statute does not exclude professional goodwill from divisible marital estate
 - Holding that when valuing a business interest that is part of the marital estate, trial courts should include the value of salable professional goodwill "attendant to the business interest"
 - Distinguishing between "enterprise goodwill" defined as "existing relationships with suppliers, customers or others" and its anticipated future customer base – due to factors attributable to the business [citing Yoon] AND
 - "Personal goodwill" as the goodwill "attributable to the individual owner's personal skill, training or reputation" [also Yoon]

GOODWILL: OPEN, CONTINUING, AND EMERGING ISSUES

- ✓ Double-Dip Arguments
- √ Validity and Application of Excess Earnings Method for Goodwill Valuation
- ✓ Alternatives to Excess Earnings Measurement of Goodwill
- ✓ Portability and Transferability of Goodwill
- √ Attempts to Contractually Exclude Goodwill as Marital Property



Determined by...

- There is no "magic formula" for determining the amount of Personal Goodwill in a business
- Is it necessary to assess the goodwill relating to the various individuals at the business?
- As to determining the specific amount, all of the methods are subjective. There is no objective way to determine Personal Goodwill

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Methods to Quantify Personal Goodwill

- Top-Down
 - Value entire entity, then separately identify and eliminate personal goodwill
- Bottom-Up
 - Value net tangible assets, then identify transferable intangible value

Methods to Quantify Personal Goodwill - Cont'd

Top - Down

- Value the business as it exists
 - Subtract out elements of personal goodwill
 - Covenant not to compete (CNTC)
 - Employment contract
 - Non-saleable personal goodwill

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Methods to Quantify Personal Goodwill - Cont'd

Bottom-Up

- Not necessarily all enterprise goodwill other intangibles may exist
 - Trained & Assembled Workforce?
 - Value of Client/Patient Lists, Charts, or Recurring Client/Patient Relationships?
 - Key Telephone numbers and E-mail addresses?
 - Going concern value?
 - Other intangibles?
- Run-off scenario?

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Determined by...

- The market based comparable transactions method would exclude non-transferrable Personal Goodwill, but to the extent there is transferrable Personal Goodwill that is embedded in a CNTC, that portion of the Personal Goodwill may need to be separately valued
- Using the "with and without" DCF method might be a way to determine the value of the Personal Goodwill embedded in the CNTC

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Quantifying Value of Personal Goodwill "With and Without" Technique

- Value the business with continued presence of the individual
- Compare it to value of the business without that individual
 - Requires assumptions regarding hiring of a replacement and the business' ability to retain customers, for example
 - Remove cash flows from customers that will not be retained
- Difference is personal goodwill
- Similar to technique applied in valuing a non-competition agreement
 - Value of a non-competition agreement depends on probability of competition, which depends on age & health of vendor, transaction structure (e.g., if vendor received shares of acquirer)

Quantitative Considerations

- Number of relevant years how determined?
- Revenue with/without key person
- Expenses with/without key person
- Discount rate(s) with/without key person
- Other issues

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Determined by...

Another method is to use the factors in *Lopez v. Lopez*:

- The age and health of the professional
- The professional's demonstrated earning power
- The professional's reputation in the community for judgment, skill, and knowledge
- The professional's comparative professional success
- The nature and duration of the professional's practice, either as a sole proprietor or as a contributing member of a partnership or professional corporation

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The Genesis of the Excess Earnings Method (EEM)

- Appeals and Review Memorandum 34 (ARM34) issued in 1920 by the U.S. Treasury Department to value distilleries and breweries when shut down by the government
- Revenue Ruling 68-609 (RR 68-609) issued by the Internal Revenue Service in 1968 to "refine" the application of the EEM Method.
- "(Capitalization of excess earnings) is perhaps the most commonly relied upon approach for valuing professional practices." Christopher A. Tiso, Present Positions on Professional Goodwill, BVR'S Guide to Personal v. Enterprise Goodwill, Fifth Edition, p. 171.

Excess Earnings Method – Base case example data

| Total enterprise net income | | \$ | 4,000,000 |
|---|-----------------|----|-----------|
| · | | ڔ | 4,000,000 |
| Sally Jones profit sharing percentage | | | 15.0% |
| Sally Jones share of enterprise net income | | \$ | 600,000 |
| Sally Jones distributions for 202X | | \$ | 550,000 |
| Sally Jones average distributions for 202W to 202X | | \$ | 650,000 |
| | | | |
| | | | |
| Reasonable replacement compensation for Ms. Jones - survey #1 | Median | \$ | 525,000 |
| Reasonable replacement compensation for Ms. Jones - survey #1 | 75th percentile | \$ | 625,000 |
| | | | |
| Reasonable replacement compensation for Ms. Jones - survey #2 | Median | \$ | 460,000 |
| Reasonable replacement compensation for Ms. Jones - survey #2 | 75th percentile | \$ | 540,000 |

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Excess Earnings Method – Base case example calculations

| Sally Jones share of profits for 202X | \$ 600,000 | | |
|---|-----------------|-----------------|---------------|
| Sally Jones distributions for 202X | | \$ 550,000 | |
| Sally Jones average dist for 202W/X | | | \$ 650,000 |
| | | | |
| | | | |
| Less: Median replacement compensation | (525,000) | (525,000) | (525,000) |
| Calculated "excess earnings" for Ms. Jones | \$ 75,000 | \$ 25,000 | \$ 125,000 |
| | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ 225,000 | \$ 75,000 | \$ 375,000 |
| Times a 25.0% capitalization rate(4x multiple) | \$ 300,000 | \$ 100,000 | \$ 500,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ 375,000 | \$ 125,000 | \$ 625,000 |
| | | | |
| | | | |
| Less: 75th Percentile replacement compensation | (625,000) | (625,000) | (625,000) |
| Calculated "excess earnings" for Ms. Jones | \$ (25,000) | \$ (75,000) | \$ 25,000 |
| | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ (75,000) | \$ (225,000) | \$ 75,000 |
| Times a 25.0% capitalization rate (4x multiple) | \$ (100,000) | \$ (300,000) | \$ 100,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ (125,000) | \$ (375,000) | \$ 125,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ (125,000) | \$ (375,000) | \$ 125,000 |

Excess Earnings Method – What is Sally's compensation?

| Sally Jones share of profits for 202X | \$ 600,000 | | |
|---|-----------------|-----------------|---------------|
| Sally Jones distributions for 202X | | \$ 550,000 | |
| Sally Jones average dist for 202W/X | | | \$ 650,000 |
| | | | |
| | | | |
| Less: Median replacement compensation | (525,000) | (525,000) | (525,000) |
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| Times a 25.0% capitalization rate(4x multiple) | \$ 300,000 | \$ 100,000 | \$ 500,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ 375,000 | \$ 125,000 | \$ 625,000 |
| Less: 75th Percentile replacement compensation | (625,000) | (625,000) | (625,000) |
| Calculated "excess earnings" for Ms. Jones | \$ (25,000) | \$ (75,000) | \$ 25,000 |
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Excess Earnings Method – What is Sally's reasonable replacement compensation?

| Sally Jones share of profits for 202X | \$ 600,000 | | |
|---|-----------------|-----------------|---------------|
| Sally Jones distributions for 202X | | \$ 550,000 | |
| Sally Jones average dist for 202W/X | | | \$ 650,000 |
| | | | |
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| Times a 20.0% capitalization rate (5x multiple) | \$ 375,000 | \$ 125,000 | \$ 625,000 |
| | | | |
| | | | |
| Less: 75th Percentile replacement compensation | (625,000) | (625,000) | (625,000) |
| Calculated "excess earnings" for Ms. Jones | \$ (25,000) | \$ (75,000) | \$ 25,000 |
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| Times a 33.3% capitalization rate (3x multiple) | \$ (75,000) | \$ (225,000) | \$ 75,000 |
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Excess Earnings Method – What is Sally's reasonable replacement compensation? – Cont'd

| Sally Jones share of profits for 202X | \$ 600,000 | | | |
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| Less: Median replacement compensation | (525,000) | (525,000) | | (525,000) |
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| | | | | |
| | | | | |
| Less: 75th Percentile replacement compensation | (625,000) | (625,000) | | (625,000) |
| Calculated "excess earnings" for Ms. Jones | \$ (25,000) | \$ (75,000) | \$ | 25,000 |
| | | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ (75,000) | \$ (225,000) | \$ | 75,000 |
| Times a 25.0% capitalization rate (4x multiple) | \$ (100,000) | \$ (300,000) | \$ | 100,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ (125,000) | \$ (375,000) | \$ | 125,000 |
| | , , , | , , , | · | , |

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Excess Earnings Method – What is Sally's reasonable replacement compensation? – Cont'd

| | _ | | | |
|---|----|-----------|-----------------|---------------|
| Sally Jones share of profits for 202X | \$ | 600,000 | | |
| Sally Jones distributions for 202X | | | \$ 550,000 | |
| Sally Jones average dist for 202W/X | | | | \$ 650,000 |
| | | | | |
| | | | | |
| Less: Median replacement compensation | | (525,000) | (525,000) | (525,000) |
| Calculated "excess earnings" for Ms. Jones | \$ | 75,000 | \$ 25,000 | \$ 125,000 |
| | | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ | 225,000 | \$ 75,000 | \$ 375,000 |
| Times a 25.0% capitalization rate(4x multiple) | \$ | 300,000 | \$ 100,000 | \$ 500,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ | 375,000 | \$ 125,000 | \$ 625,000 |
| | | | | |
| | | | | |
| Less: 75th Percentile replacement compensation | | (625,000) | (625,000) | (625,000) |
| Calculated "excess earnings" for Ms. Jones | \$ | (25,000) | \$ (75,000) | \$ 25,000 |
| | | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ | (75,000) | \$ (225,000) | \$ 75,000 |
| Times a 25.0% capitalization rate (4x multiple) | \$ | (100,000) | \$ (300,000) | \$ 100,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ | (125,000) | \$ (375,000) | \$ 125,000 |

Excess Earnings Method – What is Sally's reasonable replacement compensation? – Cont'd

| Sally Jones share of profits for 202X | \$ 600,000 | | |
|---|-----------------|-----------------|---------------|
| Sally Jones distributions for 202X | | \$ 550,000 | |
| Sally Jones average dist for 202W/X | | | \$ 650,000 |
| | | | |
| | | | |
| Less: Median replacement compensation | (525,000) | (525,000) | (525,000) |
| Calculated "excess earnings" for Ms. Jones | \$ 75,000 | \$ 25,000 | \$ 125,000 |
| | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ 225,000 | \$ 75,000 | \$ 375,000 |
| Times a 25.0% capitalization rate(4x multiple) | \$ 300,000 | \$ 100,000 | \$ 500,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ 375,000 | \$ 125,000 | \$ 625,000 |
| | | | |
| | | | |
| Less: 75th Percentile replacement compensation | (625,000) | (625,000) | (625,000) |
| Calculated "excess earnings" for Ms. Jones | \$ (25,000) | \$ (75,000) | \$ 25,000 |
| | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ (75,000) | \$ (225,000) | \$ 75,000 |
| Times a 25.0% capitalization rate (4x multiple) | \$ (100,000) | \$ (300,000) | \$ 100,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ (125,000) | \$ (375,000) | \$ 125,000 |

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Excess Earnings Method – What is Sally's reasonable replacement compensation? – Cont'd

| Sally Jones share of profits for 202X | \$ 600,000 | | |
|---|-----------------|-----------------|---------------|
| Sally Jones distributions for 202X | | \$ 550,000 | |
| Sally Jones average dist for 202W/X | | | \$ 650,000 |
| | | | |
| | | | |
| Less: Median replacement compensation | (525,000) | (525,000) | (525,000) |
| Calculated "excess earnings" for Ms. Jones | \$ 75,000 | \$ 25,000 | \$ 125,000 |
| | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ 225,000 | \$ 75,000 | \$ 375,000 |
| Times a 25.0% capitalization rate(4x multiple) | \$ 300,000 | \$ 100,000 | \$ 500,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ 375,000 | \$ 125,000 | \$ 625,000 |
| | | | |
| | | | |
| Less: 75th Percentile replacement compensation | (625,000) | (625,000) | (625,000) |
| Calculated "excess earnings" for Ms. Jones | \$ (25,000) | \$ (75,000) | \$ 25,000 |
| | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ (75,000) | \$ (225,000) | \$ 75,000 |
| Times a 25.0% capitalization rate (4x multiple) | \$ (100,000) | \$ (300,000) | \$ 100,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ (125,000) | \$ (375,000) | \$ 125,000 |
| , , | | | |

Excess Earnings Method – What is the value of Sally's practice goodwill?

| Sally Jones share of profits for 202X | \$ 600,000 | | |
|---|-----------------|-----------------|---------------|
| Sally Jones distributions for 202X | | \$ 550,000 | |
| Sally Jones average dist for 202W/X | | | \$ 650,000 |
| | | | |
| | | | |
| Less: Median replacement compensation | (525,000) | (525,000) | (525,000) |
| Calculated "excess earnings" for Ms. Jones | \$ 75,000 | \$ 25,000 | \$ 125,000 |
| | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ 225,000 | \$ 75,000 | \$ 375,000 |
| Times a 25.0% capitalization rate(4x multiple) | \$ 300,000 | \$ 100,000 | \$ 500,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ 375,000 | \$ 125,000 | \$ 625,000 |
| | | | |
| | | | |
| Less: 75th Percentile replacement compensation | (625,000) | (625,000) | (625,000) |
| Calculated "excess earnings" for Ms. Jones | \$ (25,000) | \$ (75,000) | \$ 25,000 |
| | | | |
| Times a 33.3% capitalization rate (3x multiple) | \$ (75,000) | \$ (225,000) | \$ 75,000 |
| Times a 25.0% capitalization rate (4x multiple) | \$ (100,000) | \$ (300,000) | \$ 100,000 |
| Times a 20.0% capitalization rate (5x multiple) | \$ (125,000) | \$ (375,000) | \$ 125,000 |

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What happens when the small practitioner dies or becomes disabled?

Chronology

Goodwill value (and loss)

- Day before death/incapacity 100%
- Date of death/incapacity -10 to -20%
- Each <u>day</u>, the first week -1 to -3%
- Each day, 2nd week to end of first month -2 to -4%
- Value after one month 20 to 60% of original value

The Fledge Factors

 Goodwill is the intangible expectation of continued public patronage of an enterprise. In a professional practice capable of being sold, goodwill may exist even though it is not on the market or readily saleable. Value of goodwill in such a practice depends upon the practitioner's age, health, past earning power, reputation in the community, and professional success.

• - 91 Wn.2d 324, 588 P.2d 1136

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In re Marriage of Lopez – 113 Cal, Rapt. 58 (38 Cal. App. 3d 1044 (1974)

Factors listed in this case to be considered when valuing professional goodwill:

- The age and health of the practitioner
- The professional's <u>demonstrated earning power</u>.
- The professional's <u>reputation in the community</u> for judgment, skill, and knowledge.
- The professional's <u>comparative professional success</u>.
- The <u>nature and duration of the professional's practice</u>, either as a sole proprietor or as a contributing member of a partnership or professional corporation.

"Superstar" Model

- Extraordinary People
- Natural Leader
- Strong Personalities
- Only the Strong Survive
- Entrepreneurial mindset creating, changing, inventing, experimenting, risk taking

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Slide 57

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"Operator" Model

- Extraordinary Processes
- Strong Infrastructure
- More processes, support & methodology
- Career management, mentoring & "pathing"
- Consistency, controls, setting standards, compliance orientation, slow but sure improvement, low risk tolerance

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Slide 58

The "MUM" Theory

- MUM Multiattribute Utility Theory
- Developed by David Wood, CPA/ABV, CVA in 2003
- "MUM provides a step-by-step guide that should offer a reasonable position against evidentiary challenges, allow for a consistent method for the allocations from case to case, and a comprehensive method that objectively addresses this imprecise task."

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The "MUM" Theory continued

- Generally applied as follows:
 - Define an objective
 - Establish alternatives
 - Define attributes
 - Measure the utility of each attribute
 - Aggregate the results (i.e., do the math)
 - Evaluate the alternatives
 - Express an opinion
- Upheld in In Re Marriage of Alexander, Appellate court of Illinois (5th District) No. 5-05-019, September 2006

Multiattribute Utility Model (MUM) Steps

- Establish Objective
- Qualitative and Quantitative Analysis
- Define Attributes
- Assess Attributes' Relevance and Utility
- Aggregate Results
- Step Back and Reassess Attributes
- Express Opinion

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Defining Attributes – An Example

- In this example framework, there are 20 total attributes, in two categories:
 - 10 personal
 - 10 enterprise
- Within each sample category, a further breakdown between:
 - Personal
 - Business
 - Industry You have choice of which attributes to include, but you should start with a balance

Personal Goodwill Attributes

- Personal Group Individual efforts, inherent to the individual
- Business Group
 Management decisions affecting operations, finances, service, or image
- Industry Group Industry characteristics, as opposed to actions of individuals or management

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| | | | Mul | ti-Attribu | te Utility Model | | | | |
|--|-----------------------|----------------------|---------------|------------|--|-----------------------|----------------------|---------------|---------|
| Professional Goodwill Attributes (PGA) | Importance Utility | Existence Utility | Mult. Utility | Percent | Enterprise Goodwill Attributes (EGA) | Importance Utility | Existence Utility | Mult. Utility | Percent |
| Ability, Skill and Judgement | 5 | 4 | 20 | 10.64% | Business Location | 5 | 4 | 20 | 10.64% |
| Personal Reputation | 3 | 3 | 9 | 4.79% | Business Reputation | 5 | 4 | 20 | 10.64% |
| Work Habits | 3 | 3 | 9 | 4.79% | Repeating Revenue Stream | 5 | 4 | 20 | 10.64% |
| Closeness of Contact | 3 | 2 | 6 | 3.19% | Systems and Organization | 5 | 4 | 20 | 10.64% |
| In-bound Personal Referrals | 3 | 2 | 6 | 3.19% | Multiple Service Providers | 5 | 3 | 15 | 7.98% |
| Staff, Personal | 3 | 2 | 6 | 3.19% | Business Name | 3 | 3 | 9 | 4.79% |
| Age and Health | 1 | 4 | 4 | 2.13% | Inbound Referrals | 3 | 3 | 9 | 4.79% |
| Important Personal Nature | 1 | 2 | 2 | 1.06% | Staff, Enterprise | 3 | 3 | 9 | 4.79% |
| Marketing and Branding | 1 | 1 | 1 | 0.53% | Marketing and Branding | 3 | 1 | 3 | 1.60% |
| Personalized Name | 1 | - | - | 0.00% | Multiple Locations | 1 | - | - | 0.00% |
| Total Multiplicative Utility (PGA) | | | 63 | 33.51% | Total Multiplicative Utility (EGA) | | | 125 | 66.49% |
| Personal Goodwill Allocation (Rounded) | | | | 35% | Enterprise Goodwill Allocation (Rounded) | | | | 65% |
| Total Multiplicative Utility (PGA+EGA) | | | 188 | 100.00% | | | | | |
| (1) Importance Utility is ranked in three cat (2) Existence Utility is weighted from 0-4. (| • | | | | | | | | |

MUM Method Example

- Intrinsic Value of a Solo Veterinary Practice \$1,000,000
- Less: Tangible Asset Value (100,000)

• Total Goodwill 900,000

Percent of Personal Goodwill under MUM

• Personal Goodwill

\$

35%

\$ 315,000

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MUM Method Example (Con't)

• Intrinsic value of a solo Veterinary practice \$1,000,000

• Less: Personal Goodwill (315,000)

Value of practice in the marital estate \$ 685,000



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