

Are you Poore ?
or
Do you want Moore ?

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What is Goodwill?

Poore or Moore ?

Goodwill Illustrated: Apple, Inc.

Total Shares Outstanding (billions)	4.735
Times: Price per Share	\$200
	<hr/>
Equals: Total Company Value (billions)	\$950
Less: Net Value of Tangible Assets (billions)	(\$100)
	<hr/>
Equals: Goodwill (Intangible) Value (billions)	\$850

Poore or Moore ?

Goodwill Defined (NC)

Goodwill is commonly defined as the expectation of continued public patronage.

It is an intangible asset which defies precise definition and valuation.

It is clear, however, that goodwill exists, that it has value, and that it has limited marketability.

Poore v. Poore, 331 S.E.2d 266 (1985)

Poore or Moore ?

Goodwill Defined (SC)

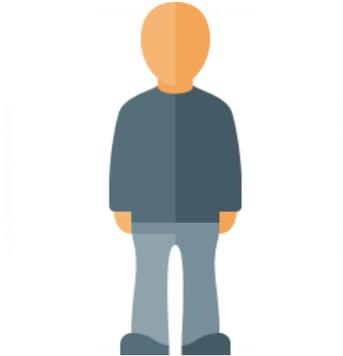
When marketable businesses are bought and sold upon the open market, the actual negotiated price for the conveyance is often greater than the total value of the tangible assets of the business involved. This difference is due to the fact that the income of a business depends upon many factors other than its assets. Many of these factors are transferred along with the business: for example, a convenient location, the reputation of a trade name, or even simply the probability that the old customers will resort to the old place. Because these factors are transferable, persons who purchase a business upon the open market are often willing to pay more than the total value of the business' individual hard assets. This additional element of value is called *goodwill*.

Moore v. Moore, 779 S.E.2d 533 (SC 2015), citing 2 Equit. Distrib. of Property, 3d § 6:73

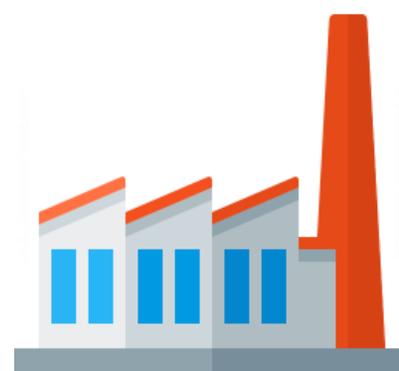
Two Different Types of Goodwill

Poore or Moore ?

**Personal
(Professional)
Goodwill**



**Enterprise
(Entity)
Goodwill**

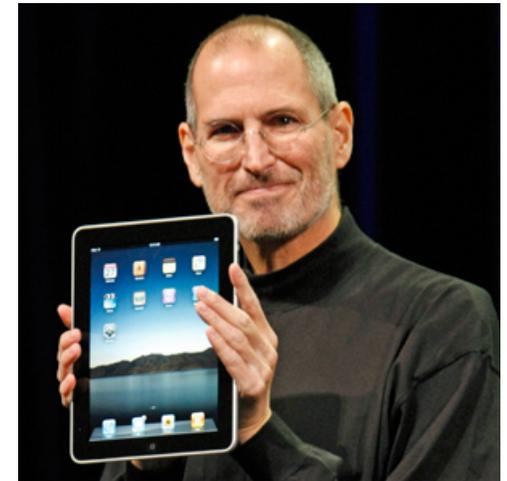


Poore or Moore ?



Atticus Finch Law, PLLC
(Atticus Finch, sole practitioner)

Apple, Inc.
(Steve Jobs, Founder and CEO)



Poore or Moore ?

Personal Goodwill Indicators

Small entrepreneurial business highly dependent on employee-owner's personal skills and relationships.

No employment agreement between company and owner-employee.

Personal service is an important selling feature in the company's products or services.

No significant capital investment in either tangible or identifiable tangible assets.

Enterprise Goodwill Indicators

Larger business with formalized organizational structures and institutionalized systems/controls.

Owner-employee has employment agreement with company.

Business is not heavily dependent on personal services.

Significant capital investment in either tangible or identifiable tangible assets.

Poore or Moore ?

Personal Goodwill Indicators

Only owner-employees own the company.

Sales depend on owner-employee's personal relationships with customers.

Product and/or services know-how and supplier relationships rest primarily with the owner-employee.

Enterprise Goodwill Indicators

Multiple owners, some not employees.

Sales result from name recognition, sales force, sales contracts, and other company-owned intangibles.

Company has supplier contracts and formalized production methods, patents, copyrights, business systems, etc.

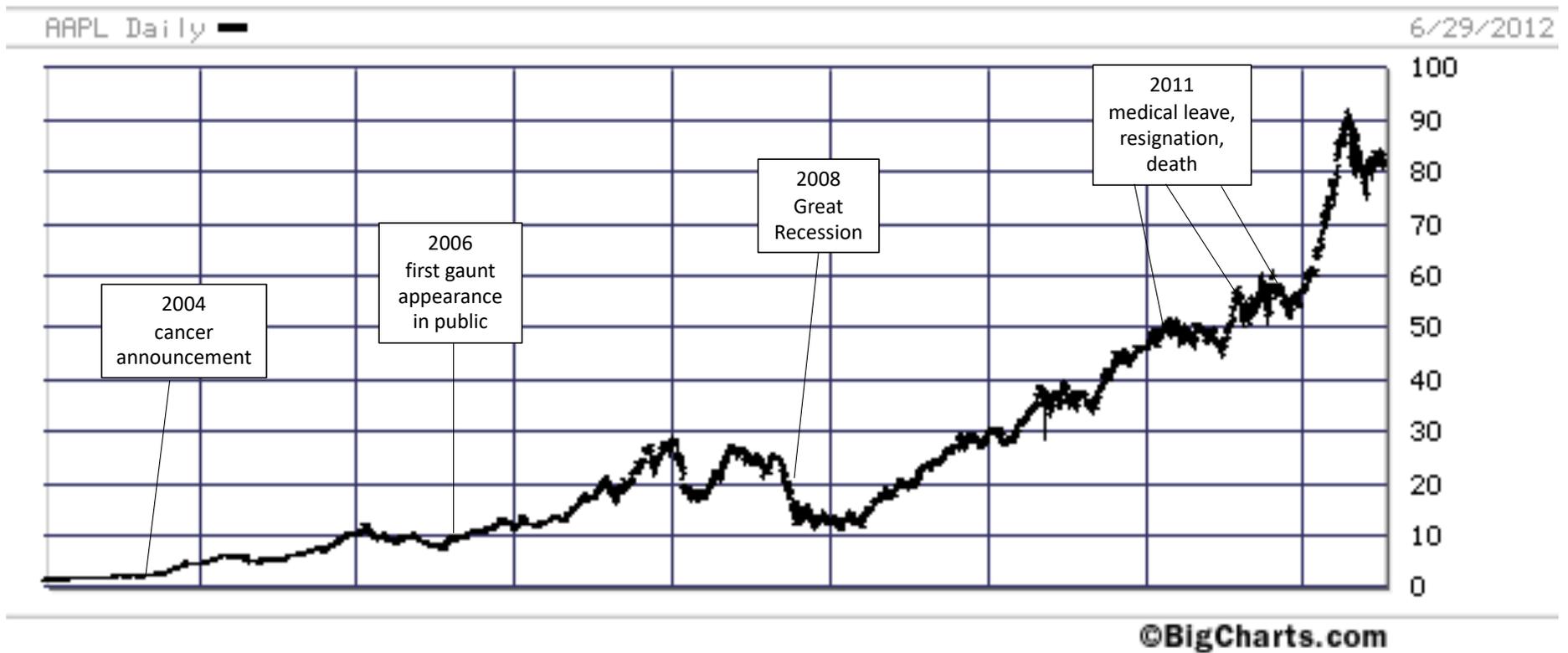
Moore, citing BVR Guide at 334

Poore or Moore ?

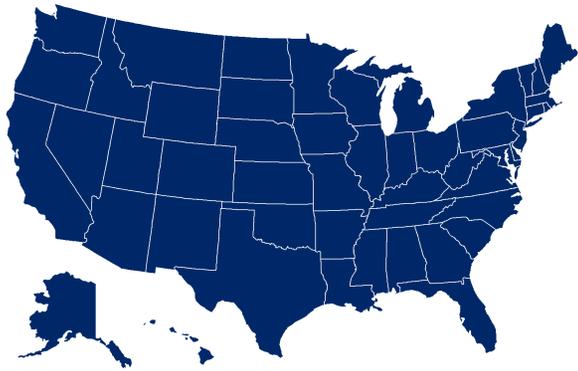
What is the value of
Atticus Finch Law, PLLC
in the Estate of
Atticus Finch?



Impact of Steve Jobs' Cancer and Death on Apple's Stock Price



The National Scorecard



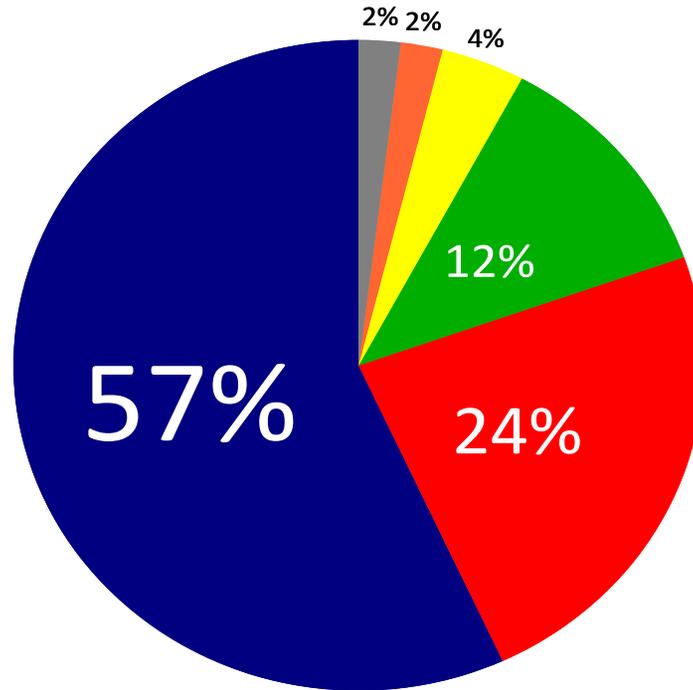
Poore or Moore ?

Goodwill Treatment	# of States	% of Total
Personal is SEPARATE, Enterprise is MARITAL (SC)	29	57%
Personal AND Enterprise are MARITAL (NC ???)	12	24%
“It’s complicated”	6	12%
Focus on salability / marketability of goodwill	2	4%
Personal AND Enterprise are SEPARATE	1	2%
No decision	1	2%
Totals (rounded)	51	100%

Charting Goodwill Jurisprudence (as of March 2019) by Business Valuation Resources, LLC

Poore or Moore ?

- Personal is SEPARATE, Enterprise is MARITAL
- Personal AND Enterprise are MARITAL (NC?)
- "It's Complicated"
- Focus on Marketability of Goodwill
- Personal AND Enterprise are SEPARATE
- No Decision



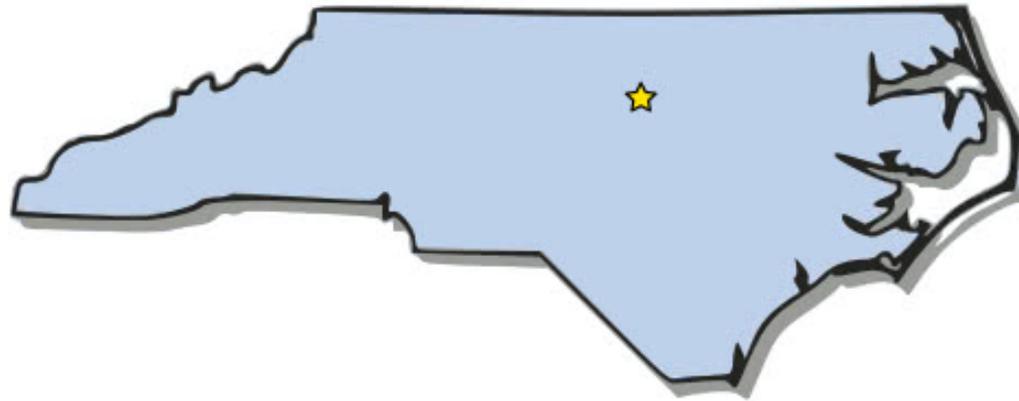
Poore or Moore ?

“It’s Complicated” - California style:

Consistent with the concept of community property, if professional goodwill is found to exist as an asset at the time of the marital dissolution, it may be separate property, community property, or varying degrees of both depending on the particular circumstances.

In re Marriage of Lopez, 38 Cal. App. 3d 93 (1974)

North Carolina is *Poore*





Poore or Moore ?

Poore v. Poore, 331 S.E.2d 266 (1985)



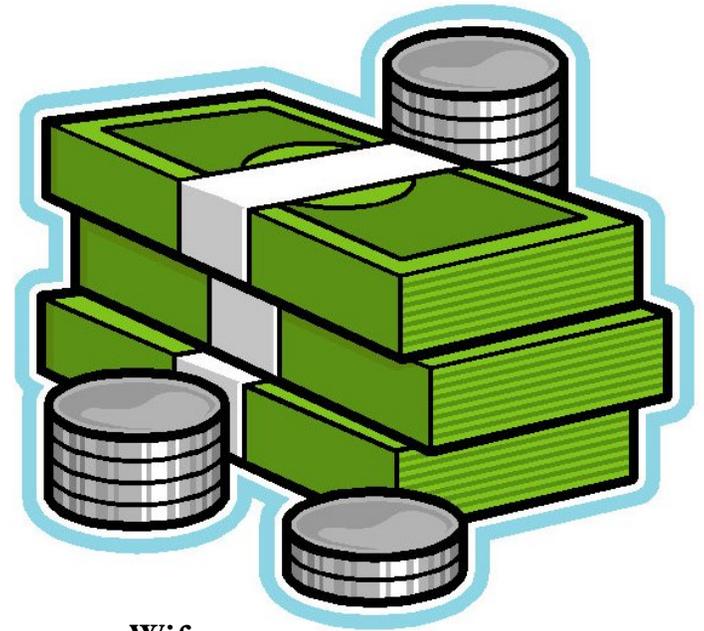
Husband
\$7,500

Net Asset Value
(assets minus
liabilities)



Trial Court
\$75,000

“available evidence
including tangible
assets and net income”
(total assets)



Wife
\$232,000
1x Revenues

Poore or Moore ?

“The [trial] court’s valuation of the practice does not appear to be based on a sound method of valuation nor is it supported by the evidence.

For this reason, we vacate the equitable distribution order and remand for a new hearing on the value of the professional association.”

Poore v. Poore, 331 S.E.2d 266 (1985)

Poore or Moore ?

Poore v. Poore, 331 S.E.2d 266 (1985)

- No set rule for determining the value of the goodwill of a professional practice.
- Each case must be determined in light of its own particular facts.
- The determination of the existence and value of goodwill is a question of fact and not of law, and should be made with the aid of expert testimony.
- Courts are cautioned to value goodwill “with great care, for the individual practitioner will be forced to pay the ex-spouse ‘tangible’ dollars for an intangible asset at a value concededly arrived at on the basis of some uncertain elements.”

Poore or Moore ?

Poore v. Poore, 331 S.E.2d 266 (1985)

Among the factors which may affect the value of goodwill and which therefore are relevant in valuing it are:

- The age, health, and professional reputation of the practitioner,
- The nature of the practice,
- The length of time the practice has been in existence,
- The past profits of the practice,
- The comparative professional success of the practice, and
- The value of the other assets of the practice.

Poore or Moore ?

Poore v. Poore, 331 S.E.2d 266 (1985)

Various appraisal methods can be and have been used to value goodwill:

- Determine the market value of the goodwill, i.e., the price that a willing buyer would pay to a willing seller for it.
- One year's average gross income of the practice, or a percentage thereof.
- Evidence of sales of comparable practices.
- A capitalization of excess earnings approach. Under this approach, the value of goodwill is based in part on the amount by which the earnings of the professional spouse exceed that which would have been earned by a person with similar education, experience, and skill as an employee in the same general locale.

The Capitalization of Excess Earnings Approach

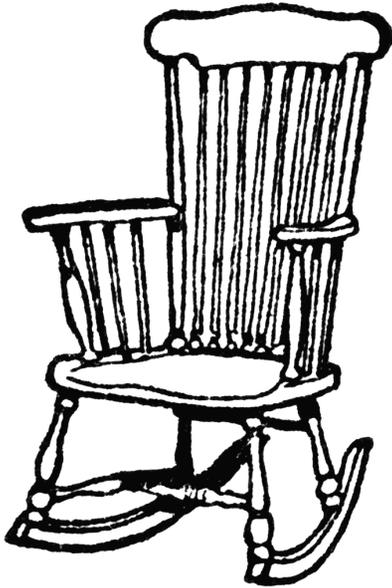
Poore or Moore ?

The Capitalization of Excess Earnings Approach
is **NOT** the Excess Earnings Approach

The Capitalization of Excess Earnings Approach
is an **INCOME APPROACH**

Poore or Moore ?

Capitalization of Excess Earnings Method: Tar Heel Rocking Chair Company



Revenues	\$10,000,000	\$10,000,000
Less: Operating Expenses	(\$9,000,000)	(\$9,000,000)
Less: Owner's Compensation	(\$1,000,000)	NA
Less: Market Compensation	NA	(\$200,000)
	<hr/>	
Equals: Net Profit ("Excess Earnings")	\$0	\$800,000
Divided by: Cap Rate	20%	20%
	<hr/>	
Equals: Value	\$0	\$4,000,000

Poore or Moore ?

Compensation Adjustment to Market Rate

Keep in mind that the owner of a closely held business receives two forms of compensation. First, as an employee, that individual is entitled to a return on his or her labor (salary for the job being performed). Second, as an owner, that individual receives a return on investment (dividends or capital appreciation). Be very careful not to confuse the two. The officer's compensation adjustment is intended to restate the economic income statement of the company to a basis that includes the amount of salary that would be necessary to attract others who are qualified to perform the duties required by the company.

Understanding Business Valuation, A Practical Guide to Valuing Small to Medium Sized Businesses, Fifth Edition, by Gary R. Trugman, CPA/ABV, MCBA, ASA, MVS

Poore or Moore ?

Poore v. Poore, 331 S.E.2d 266 (1985)

Under the capitalization of excess earnings approach, the value of goodwill is based in part on the amount by which the earnings of the professional spouse exceed that which would have been earned by a person with:

- similar education,
- experience,
- skill,
- as an employee
- in the same general locale.

The Capitalization of Excess Earnings Approach:

Applying Poore in Hamby

Poore or Moore ?

Hamby v. Hamby, 143 N.C. App 635, 547 S.E.2d 110 (2001)

In *Hamby*, the sole valuation methodology accepted by the trial court and affirmed by the Court of Appeals was the capitalization of excess earnings approach from *Poore*.

The trial and appellate courts in *Hamby* accepted the proposition that an insurance agency owner earning \$105,000 per year could hire a “person with similar education, experience, and skill as an employee in the same general locale” for \$47,000 per year, leaving the owner with a \$58,000 annual profit that would then be capitalized into a value for the agency.

Poore or Moore ?

Hamby v. Hamby, 143 N.C. App 635, 547 S.E.2d 110 (2001)

Revenues	\$225,000	\$225,000
Less: Operating Expenses	(\$120,000)	(\$120,000)
Less: Owner's Compensation	(\$105,000)	NA
Less: "Market Compensation"	NA	(\$47,000)
<hr/>		
Equals: Pre-tax Profit	\$0	\$58,000
Less: Income Taxes	(\$0)	(\$22,000)
<hr/>		
Equals: Net Profit	\$0	\$36,000
Divided by: Cap Rate	28%	28%
<hr/>		
Equals: Value (before DLOM)	\$0	\$128,000



Poore or Moore ?

Hamby v. Hamby, 143 N.C. App 635, 547 S.E.2d 110 (2001)

What happens when a \$47,000 person tries to do a \$105,000 job?

1. The \$47,000 person CANNOT do it. The company's performance suffers and the value of the company declines.
2. The \$47,000 person CAN do it and demands to be paid the market rate of compensation for his services (\$105,000). What rational individual does \$105,000 of work for \$47,000?

The Hamby Insurance Agency is NOT the same situation as the Tar Heel Rocking Chair Company

Poore or Moore ?

Hamby v. Hamby, 143 N.C. App 635, 547 S.E.2d 110 (2001)

“If Rick Hamby was somebody who laid up in bed and stayed drunk all the time, this business would not have value.”

~~Business~~ People Valuations

Poore or Moore ?



Typical Operating Company

1. Transferable entity.
2. Logical compensation adjustment exists.



Rick Hamby Insurance Agency

1. Non-transferable entity.
2. No logical compensation adjustment.

THE SLIPPERY SLOPE



John Smith, Individual

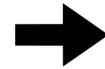
1. No entity.
2. No logical compensation adjustment.

Poore or Moore ?

Business People Valuations

Three-step process for a People Valuation:

1. Reclassify the individual as an “entity.”
2. Reclassify the individual’s compensation as the “revenues” of the fabricated “entity.”
3. Use an artificially low “market compensation” figure to subtract from the reclassified “revenues” to generate a “profit” for the “entity” that can then be capitalized into a “value.”



Poore or Moore ?

Business People Valuations

Can anybody and everybody

(owner, independent contractor, employee)

be classified as a sole proprietor for this purpose?

Poore or Moore ?

Business People Valuations

NO

Sonek v. Sonek, 105 N.C. App. 247, 412 S.E.2d 917 (1992): We, therefore, find that a salaried employee who maintains no ownership interest in the particular place of employment does not possess goodwill.

Sonek citing *In re Marriage of Hall, 103 Wash. 2d 236, 692 P.2d 175 (1984):* The salaried professional brings an earning capacity comprised of skill and education to the position. However, when the salaried professional leaves a position, he takes everything with him to the new position. There is nothing that increased his earning capacity in the old salaried position that cannot be taken to the new position.

Poore or Moore ?

The Hard-Working Independent Contractor MD

Real World		People Valuation	
Actual Compensation	\$500,000	“Revenues”	\$500,000
Less: Actual Comp	<u>(\$500,000)</u>	Less: “Market Comp”	<u>(\$300,000)</u>
Equals: Net Profit	\$0	Equals: “Net Profit”	\$200,000
Divided by: Cap Rate	<u>20%</u>	Divided by: Cap Rate	<u>20%</u>
Equals: Value	\$0	Equals: “Value”	\$1,000,000

Personal and Enterprise Goodwill in NC

Poore or Moore ?

Does *Poore* Lump Personal and Enterprise Goodwill together?

OR

Does *Poore/Hamby* Delineate Personal and Enterprise Goodwill?

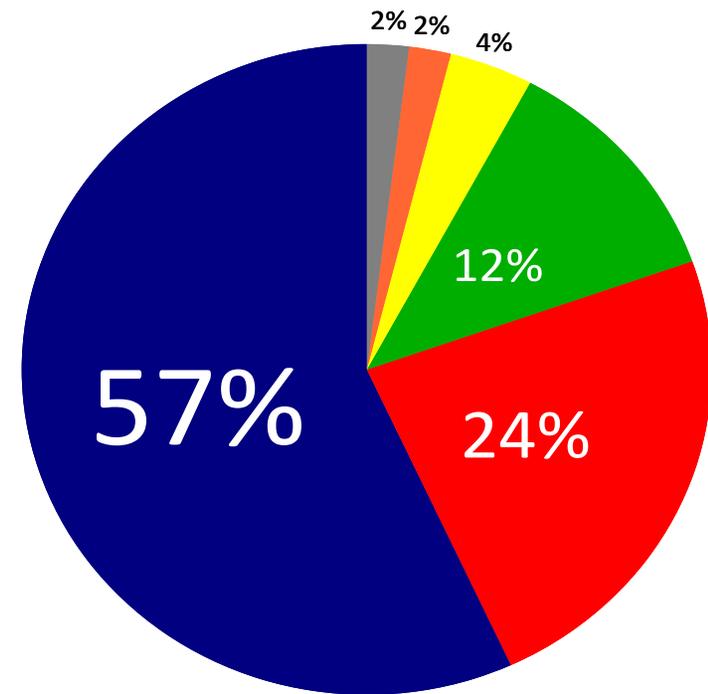
“Although some courts have refused to consider goodwill in valuing a professional practice, the **vast majority of courts** which have ruled on the question have held that the **goodwill** of a professional practice is property of value which should be included among the assets distributed upon the dissolution of a marriage. We agree that **goodwill** is an asset that must be valued and considered in determining the value of a professional practice for purposes of equitable distribution.” *Poore*, 331 S.E.2d at 271.

Poore or Moore ?

The **vast majority** of courts which have ruled on the question have held that the goodwill of a professional practice is property of value which should be included among the assets distributed upon the dissolution of a marriage.

Poore, 331 S.E.2d at 271

- Personal is SEPARATE, Enterprise is MARITAL
- Personal AND Enterprise are MARITAL (NC?)
- "It's Complicated"
- Focus on Marketability of Goodwill
- Personal AND Enterprise are SEPARATE
- No Decision



Poore or Moore ?

Does *Poore/Hamby* Delineate Personal and Enterprise Goodwill?

Assume a physician who works at a large, multi-physician, dominant medical practice.

The physician earns \$550,000 per year in compensation.

The industry median compensation for this specialty is \$400,000 per year.

The 75th percentile industry compensation for this specialty is \$500,000 per year.

Question: What factors influence this physician's ability to earn an above-market compensation?

Specifically: To what extent is this physician's earnings due to PERSONAL goodwill and to what extent is it due to ENTERPRISE goodwill?

Poore or Moore ?

Does *Poore/Hamby* Delineate Personal and Enterprise Goodwill?

	Actual Results	Median Comp	75 th % Comp
Revenues	\$1,000,000	\$1,000,000	\$1,000,000
Less: Share of Practice Expenses	(\$450,000)	(\$450,000)	(\$450,000)
Less: Compensation	(\$550,000)	(\$400,000)	(\$500,000)
Equals: Adjusted Net Profit	\$0	\$150,000	\$50,000
Divided by: Cap Rate		20%	20%
Equals: Value		\$750,000	\$250,000



**personal AND enterprise
goodwill**



**ONLY enterprise
goodwill**

Poore or Moore ?

Does *Poore/Hamby* Delineate Personal and Enterprise Goodwill?

YES. The capitalization of excess earnings method suggested in *Poore* and applied in *Hamby* does separate personal and enterprise goodwill with personal goodwill remaining the separate, non-divisible property of the working spouse and enterprise goodwill being a divisible asset of the marital estate.

Applying the *Poore* requirement of a “person with similar education, experience, and skill as an employee in the same general locale” **NEGATES** the personal goodwill aspect of the working spouse. Assuming the market compensation for an individual with identical skills, characteristics, etc., means the personal goodwill component of value disappears.

As a result, the only goodwill value that remains is enterprise goodwill, which is divisible.

Does this put NC in the majority of states on this issue (along with SC)?

Poore or Moore ?

Does *Poore/Hamby* Delineate Personal and Enterprise Goodwill?

CAVEAT!

The capitalization of excess earnings method suggested in *Poore* and applied in *Hamby* is only one of several methodologies suggested in *Poore*. Using another suggested methodology (such as comparable sale transactions) may not isolate the personal and enterprise components of goodwill value as is done in the capitalization of excess earnings method.

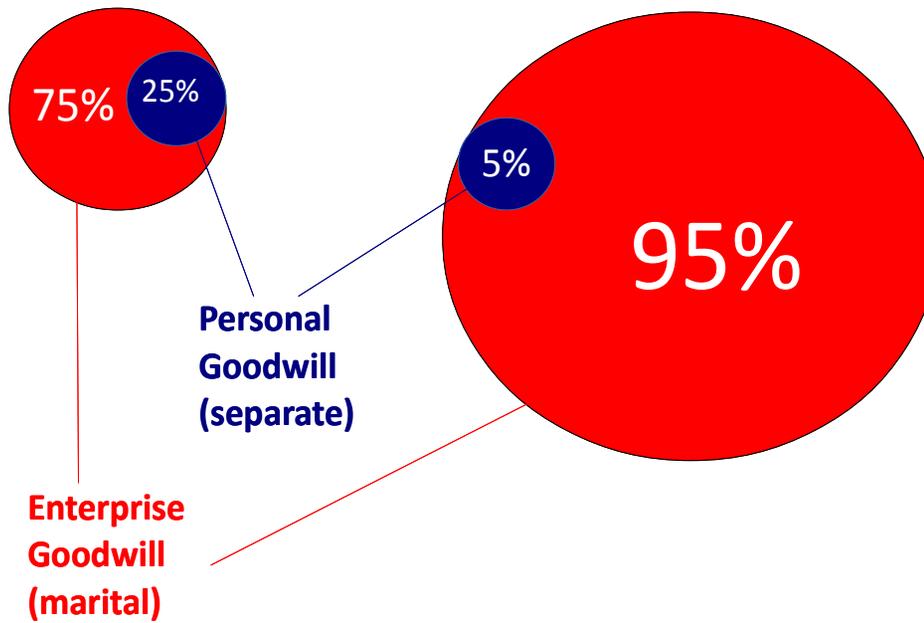
South Carolina has *Moore*



Poore or Moore ?

WIFE (OWNER)

HUSBAND



Poore or Moore ?

Moore v. Moore, 779 S.E.2d 533 (SC 2015)

Candelabra: Retail/Internet sales of high-end lighting and home furnishings/accessories	Wife	Husband	Family Court	Supreme Court
Total Company Value	\$960,000	\$2,960,000	\$2,960,000	\$1,200,000
Less: Stipulated Value of Tangible Assets	(\$354,000)	(\$354,000)	(\$354,000)	(\$354,000)
Equals: Total Goodwill Value of Company	\$606,000	\$2,606,000	\$2,606,000	\$846,000
Times: % of Goodwill Personal to Wife	25%	5%	10%	20%
Wife's Personal Goodwill (separate)	\$151,500	\$130,300	\$260,600	\$169,200
Enterprise Goodwill (marital)	\$454,500	\$2,475,700	\$2,345,400	\$676,800
Times: Husband's Share of Marital Estate	50%	50%	50%	50%
Equals: Husband's Share of Enterprise Goodwill	\$227,250	\$1,237,850	\$1,172,700	\$338,400

Poore or Moore ?

The Logical Analysis and Clarity of *Moore*

- Frames the issue: Is enterprise goodwill a marital asset subject to division?
- Tells us the answer (at the beginning): Yes.
- Defines goodwill and the difference between personal and enterprise goodwill.
- Cites SC precedent holding that personal goodwill is separate property.
- Cites an accepted business valuation treatise as support for its holding.
- Cites a wide range of indicators and characteristics of each type of goodwill.
- Provides a hypothetical example illustrating the differences.
- Analyzes the specific facts of the case to reach its holding.

Poore or Moore ?

Definitions of ENTERPRISE Goodwill Cited in *Moore*

- That which exists independently of one's personal efforts and will outlast one's involvement with the business.
- Based on the intangible, but generally marketable, existence in a business of established relations with employees, customers and suppliers.
- Attaches to a business entity and is associated separately from the reputation of the owners.
- Has a determinable value because it will transfer upon the sale of the business to a willing buyer.
- An asset of the business and accordingly is property that is divisible in a dissolution to the extent that it inheres in the business, independent of any single individual's personal efforts and will outlast any person's involvement in the business.

Poore or Moore ?

Definitions of PERSONAL Goodwill Cited in *Moore*

- Associated with individuals. It is that part of increased earning capacity that results from the reputation, knowledge and skills of individual people.
- The implied assumption is that if the individual were not there, the clients would go elsewhere.
- The goodwill of a service business, such as a professional practice, consists largely of personal goodwill.
- In the family court setting, future earning capacity based on a spouse's reputation, knowledge and skills – personal goodwill – is considered nonmarketable and thus not property subject to division.
- If the goodwill depends on the continued presence of a particular individual, such goodwill, by definition, is not a marketable asset distinct from the individual.

Poore or Moore ?

Distinction between Personal and Enterprise Goodwill in *Moore*

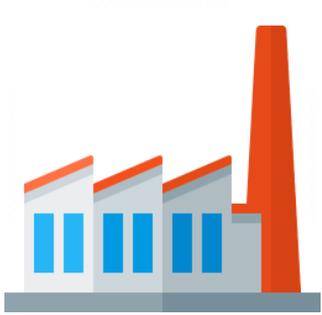
- We continue to hold that personal goodwill, which follows the owner and is entirely dependent on the owner's personal or professional services and skills, is not marital property subject to division.
- However, we are persuaded that enterprise goodwill, which inheres in the business itself and is transferrable in the market, should be distinguished from personal or professional goodwill.
- Accordingly, we elect to follow the emerging majority approach and hold enterprise goodwill is marital property subject to equitable division.

Poore or Moore ?

Finally....

Is there more than *Moore*?

Poore or Moore ?



The limitation of *Moore* :

**It dealt with a company,
not a professional practice**



Poore or Moore ?

In separating personal and enterprise goodwill, the essential question is:
Can the business generate revenue from continued patronage
without the current owner's participation?

We are persuaded that enterprise goodwill, which inheres in the
business itself and is **transferrable** in the market,
should be distinguished from personal or professional goodwill.

Moore v. Moore, 779 S.E.2d 533 (SC 2015)

Poore or Moore ?

The unanswered questions in *Moore* :

Is personal goodwill ever transferable?

Can personal goodwill have value in ED?

Poore or Moore ?

Is personal goodwill ever transferrable?



Tiger Woods

Poore or Moore ?

Real World Tiger Woods (2007-2009 Avg)

Winnings/Endorsements	\$120,000,000
Less: Actual Comp	<u>(\$120,000,000)</u>
Equals: Net Profit	\$0
Divided by: Cap Rate	<u>20%</u>
Equals: Value	\$0



People Valuation of Tiger Woods

“Revenues” of Woods Golf Inc.	\$120,000,000
Less: “Market Comp”	<u>(\$10,000,000)</u>
Equals: “Net Profit”	\$110,000,000
Divided by: Cap Rate	<u>20%</u>
Equals: “Value”	\$550,000,000



Poore or Moore ?

Is personal goodwill ever transferrable?



Solo Dental Practice

Poore or Moore ?

Median Results of 1,249 Dental Practice Sales (*The Goodwill Registry*)

	Seller	Buyer	<i>Poore/ Hamby?</i>
Revenues	\$700,000	\$700,000	\$700,000
Less: Practice Expenses	(\$425,000)	(\$425,000)	(\$425,000)
Less: Dentist Compensation	(\$275,000)	(\$275,000)	(\$209,000)
Equals: Adjusted Net Profit	\$0	\$0	\$66,000
Divided by: Cap Rate	20%	20%	20%
Equals: Value	\$0	\$0	\$330,000

NO!!!

Median Purchase Price: \$440,000

(\$110,000 tangible assets and \$330,000 goodwill)

Poore or Moore ?

Conclusion:

The capitalization of excess earnings method suggested in *Poore* and applied in *Hamby* may **NOT** capture the goodwill value in a professional practice - you may have to use a **MARKET APPROACH.**



Poore or Moore ?

Is personal goodwill ever transferrable?



Atticus Finch Law, PLLC

Poore or Moore ?

Another factor in distinguishing between personal and enterprise goodwill is the degree to which a purported purchaser would demand the seller enter into a covenant not to compete. While a covenant not to compete may be present in any transaction, the market-driven necessity for a covenant is manifest where personal goodwill is involved.

Moore, 779 S.E.2d at 546

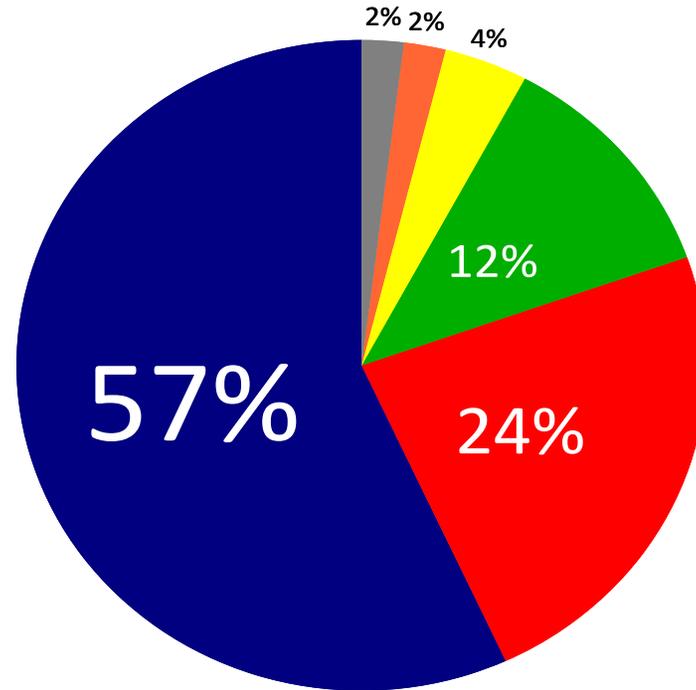
Poore or Moore ?

Poore
or
Moore
or.....
Wisconsin?



Poore or Moore ?

- Personal is SEPARATE, Enterprise is MARITAL
- Personal AND Enterprise are MARITAL (NC?)
- "It's Complicated"
- Focus on Marketability of Goodwill
- Personal AND Enterprise are SEPARATE
- No Decision



Poore or Moore ?

Wisconsin focuses on the marketability of the goodwill:

After reviewing cases that distinguish between personal and enterprise goodwill, we choose not to require circuit courts to draw a distinction between personal and enterprise goodwill when dividing a marital estate that includes professional goodwill. **This is so because the premise on which the distinction is grounded – that enterprise goodwill is saleable and personal goodwill is not – is mistaken.** As evidenced by the facts of the case at hand, [Dr. McReath] testified that when he bought Orthodontic Specialists for \$930,000, nearly 90 percent of the sale price was for the professional goodwill. [Dr. McReath] described this goodwill as including elements of “personal” goodwill: Dr. Grady’s name, the noncompete clause, and the employment agreement that Dr. Grady would stay on to introduce me to his existing patients.” **Therefore, as this case demonstrates, in some situations, personal goodwill is saleable.**

In re Marriage of McReath, 335 Wis. 2d 643, 800 N.W.2d 399 (2011)

Poore or Moore ?

The Takeaways:

1. NC needs better guidance than *Poore/Hamby*.
2. The illogical assumptions in *Poore/Hamby* can lead to people valuations.
3. The capitalization method in *Poore/Hamby* DOES delineate personal (separate) and entity (marital) goodwill – is NC really in the majority?
4. SC has much better logic/guidance with *Moore* but it's not perfect.
5. Are there different types of personal goodwill (Tiger/dentist/Atticus)?
6. Always consider a market approach.
7. Should the separate/marital line be drawn between personal/entity goodwill OR should the focus be on marketability?