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How do you value goodwill? Make the invisible...visible.

A company's goodwill is the value the owner has built through hard work, discipline, and creativity. Making the invisible goodwill visible involves several stages that assists the owner in convincing buyers of the opportunity to take the business to the next level of success and profitability.

A common item in the negotiation of a business asset sale is the goodwill and how much it is worth in the final agreement. The buyer is interested in a purchase price allocation of the assets from the seller. The allocation requires that goodwill be estimated. An accurate allocation is valuable for legal and tax planning purposes for both parties.

The accepted approach estimating goodwill is twofold process:

The first step is to determine the negotiated value of the company. In the negotiation of the sale, the seller usually provides confidential information that includes a business plan and income forecasts to discuss with the interested buyers. Some investment bankers describe this package as a confidential information memorandum. The package assists the seller in showing the value and opportunities the business provides to the interested suitors.

Once the company's overall negotiated value is determined, the fair market value of the physical assets need to be determined such as equipment, furniture, inventory and similar assets. For example, if the company's value is \$200,000 and the physical assets are \$50,000, the remainder, \$150,000, is considered goodwill.

The second step to consider is the type of goodwill to identify and either adjust it up or down based on the quality of the goodwill. The adjustments result from further negotiations between the buyer and seller:

- 1) There is institutional goodwill which may include its brand image.
- 2) The other goodwill types are associated with professional practices. This type of goodwill is known in professional service firms such as engineering, CPA, staffing, or legal firms. There are two types of professional service goodwill - practice goodwill and practitioner goodwill.



- a) Practice goodwill may be valued higher than practitioner goodwill. Buyers can more easily forecast the future income opportunity of the firm with practice goodwill. The practice goodwill is equivalent to a firm's brand image to a buyer.
- b) Key employees such as the owners or key managers of the company reflect practitioner goodwill. Practitioner goodwill is not as highly valued by some buyers, because they must be able to retain happy and productive key shareholders and employees into the future. There is a higher risk that the practitioner goodwill value falls short of the buyer's income expectations as a result of a productivity drop from a key employee(s).

To optimize the value of goodwill in your company, consider the stages in making goodwill visible and valuable. You will have a greater likelihood of reaping the rewards of your hard work and vigilance when it's time to sell.

Regular Piece

How To Make The Most Of Your Newsletter

Be sure to read the article with the mindset 'How could this apply to our business.' Thinking of it that way will guarantee that you get value. Better yet, take notes as you read and commit to having the ideas implemented by the time the next edition arrives. Also, make copies for each team member. To really make sure something positive happens, work with your business development specialist to talk your team through the ideas and how to set a schedule for getting them implemented. We're here to help you get started.

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