Dealmaker's Dialogue

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Utilizing Personal Goodwill in M&A Transactions

Authored by Deb Stephens
Vice President, 440-392-6576

In more than 80% of the C corporation deals that have closed, the seller received a discounted valuation and the buyer lost significant tax savings… either way, dollars evaporated. It is a shame that more aspiring dealmakers don't understand personal goodwill.

If a seller is a C corporation (or S corp. within the built-in gains period), it is generally believed that only a stock sale will prevent a seller from being hit with double tax. But that is not necessarily true. For buyers, a stock purchase is not preferable as it does not create a tax write off as in an asset purchase or an IRC section 338 election (buyer can deduct the purchase over 15 years for tax purposes). As a result, buyers typically pay 20% - 30% less in a stock purchase. Before sabotaging a deal due to a low ball offer or worse yet, double tax, sellers and buyers should determine if personal goodwill is applicable.

Figure 1 - Deal Scenario

	Scenario A 100% Corporate Goodwill	Scenario B 100% Stock Sale *	Scenario C 50% Personal Goodwill	Scenario D 100% Personal Goodwill
Purchase Price	$ 5,000,000	$ 3,750,000	$ 5,000,000	$ 5,000,000
Less: Personal Goodwill	0	0	2,500,000	5,000,000
Net Purchase Price to Corporation	$ 5,000,000	0	$ 2,500,000	$ 0
Corporate Tax Rate	35%	35%	35%	35%
Corporate Level Tax	1,750,000	0	875,000	0
Net Distribution to Shareholders	$ 3,250,000	$ 3,750,000	$ 1,625,000	$ 0
Plus: Personal Goodwill	0	0	2,500,000	5,000,000
Shareholder Taxable Income	$ 3,250,000	$ 3,750,000	$ 4,125,000	$ 5,000,000
Capital Gains Tax Rate	15%	15%	15%	15%
Total Capital Gains Tax	487,500	562,500	618,750	750,000
After Tax Net Proceeds	$ 2,762,500	$ 3,187,500	$ 3,506,250	$ 4,250,000
$ Increase in After Tax Proceeds	0	$ 425,000	$ 743,750	$ 1,487,500
% Increase in After Tax Proceeds	0%	15%	27%	54%

*Purchase price assumes 25% discount by typical buyer to offset loss of tax savings from inability to amortize goodwill.

Goodwill is an intangible asset arising from the reputation of a business and its relationships with customers. In an insurance agency, there are few tangible assets; almost all of the agency's value is goodwill. If it can be justified that any of the goodwill actually resides with shareholders, it may be considered personal goodwill owned by the individuals, versus corporate goodwill owned by the agency.

If applicable, the use of personal goodwill can enable 1) buyers to pay a premium given tax savings, and 2) sellers to avoid corporate level tax (the double tax) on the portion of the purchase price allocated to personal goodwill. The impact of deal structure on seller after-tax proceeds can be massive (*Figure 1*).

Many details must be considered to determine whether personal or corporate goodwill are present within an agency (*Figure 2*). Both buyers and sellers should seek the advice of a seasoned expert to determine if a deal meets the criteria for personal goodwill. The risk associated with the improper use of personal goodwill is substantial in an IRS audit. However, with proper tax treatment, buyers can achieve significant tax savings and be much more aggressive while sellers can receive a higher deal value and pay less tax.

Getting a good deal done is difficult in this environment. Countless deals that could have closed died given that this rock (personal goodwill) was left unturned. Worse yet, many sellers took a hit to value or paid too much tax. Without exploring all deal structure alternatives, seller and buyer returns are left to chance.

Figure 2 - Goodwill Indicators

Corporate	Personal
Agency business does not require a significant amount of personal service	Agency utilizes personal service to sell its insurance products
Agency is highly formalized in its organizational structures and institutionalized in its functions	Agency is highly dependent on the personal relationships and skills of the owners
Agency has made significant investments in tangible and intangible assets	Agency has made no significant investments in tangible / intangible assets
There are agency principals that are not active in the business	Agency principals are active in the business
Sales of insurance are mainly due to the company name or reputation, rather than individual producers	Sales of insurance are due to the personal relationships of the owners
Agency sales occur primarily due to carrier contracts	Insurance product knowledge lies primarily with the owners
Owners / employees have an existing non-compete or non-solicitation agreement	No existing non-compete or non-solicitation agreements for owners

MarshBerry M&A Advisory Services

Deal Strategy

1. Acquisition Planning
2. Deal Return Modeling
3. Strategic Options Analysis
4. Alternative Buyer Comparison

Deal Preparation

1. Sale Preparation Management
2. Offering Memorandum Development
3. Strategic Pitch Book Design
4. Candidate Profile Creation

Deal Representation

1. Buy Side Representation
2. Sell Side Representation
3. Letter of Intent Development / Negotiation
4. Creative Deal Structure Alternatives

Deal Analysis

1. Agency Fair Market Valuation
2. Market Comparables / Deal Benchmarking
3. After-Tax Return Optimization
4. IRR, ROI and EPS Analysis

Deal Execution

1. Diagnostic and Confirmatory Due Diligence
2. Intangible Asset Allocation - GAAP Reporting
3. Fairness Opinion
4. Definitive Agreement Best Terms and Conditions

Post-Deal Management

1. Post-Closing Integration
2. Goodwill Impairment Testing
3. Peer-to-Peer CEO Exchange
4. Earn-Out Maximum Consultation

SNL Financial
M&A Advisor Rankings

Insurance Broker Merger & Acquisition Deals
1997-2009

Rank	Firm	1997 - 2009 # of Deals	2009 # of Deals
1	**Marsh Berry & Co. Inc.***	**275**	**23**
2	Hales & Co. Inc.	123	14
3	Reagan Consulting Inc.	113	7
4	Mystic Capital Advisors Group, LLC	94	10
5	Macquarie Capital Advisors Group, LLC	43	7
6	Bank of America Merrill Lynch	22	2
7	B.H. Burke & Co., Inc.	16	0
8	Keefe Bruyette & Woods, Inc.	15	0
8	Sica Consultants, Inc.	15	3
10	North Bridge Advisors, Inc.	13	0
10	Sandler O'Neill & Partners, L.P.	13	1
12	Philo Smith & Co.	10	0
13	Credit Suisse (USA) Inc.	9	0
14	Business Management Group, Inc.	8	0
14	Curtis Financial Group, LLC	8	0
14	Harbor Capital Advisors, Inc.	8	0
14	J.P. Morgan Securities, Inc.	8	0
18	Boenning & Scattergood, Inc.	7	0
18	Gill and Roeser Holdings, Inc.	7	0
18	Nexus Group, Inc.	7	0
21	2nd Generation Capital Corporation	6	0
21	Goldman, Sachs & Co.	6	0
21	Harbor Capital Advisors, Inc.	6	0
24	Lazard Freres & Co. LLC	5	0
24	Wells Fargo Securities, LLC	5	0
26	Garland McPherson & Associates, Inc.	4	0
26	Nomura Securities International, Inc.	4	0
26	Piper Jaffray & Co.	4	1
26	Russell Miller Corporate Finance, Inc.	4	0
26	UBS Investment Bank	4	0

All States // Completed Transactions
Whole deals as reported by SNL Financial, January 15, 2010

***** MarshBerry has closed 28% of total deal flow since 1997***

MarshBerry's clients are committed to realizing their fullest potential with respect to growth, profit, survival and shareholder value. Our agent, broker, bank and carrier clientele engage us to achieve their goals within the retail and wholesale channels of the insurance distribution system. Our unparalleled industry-specific services include consulting, performance benchmarking, peer-to-peer exchange networks, merger and acquisition intermediation and producer recruiting.

MarshBerry • 4420 Sherwin Road • Willoughby, Ohio 44094 • 800-426-2774 • www.MarshBerry.com • MarshBerry@MarshBerry.com