The Business Owner's Guide to a

Buy-Sell Agreement Review

The death, disability, severe illness or retirement of a controlling owner of a business can wreak havoc on the entity that the owner may have spent a lifetime building. If not adequately planned for, such events can lead to a forced sale of the business out of family control.

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The Facts of a Properly Structured Buy-Sell Agreement

ADVANTAGES OF A BUY-SELL AGREEMENT

- Helps create a market for a closely held business.
- Assures continuation of business that owners worked hard to create.
- Establishes a purchase price for each owner's interest in the business and, if the agreement is between non-family members, may be used to establish the value of the business for estate planning purposes.
- Restricts outsiders from obtaining an interest in the business or control of the business.
- Allows co-owners the ability to purchase the exiting owner's interest.
- Insurance death benefit provides estate liquidity and cash to beneficiaries not involved in the business.
- The potential for cash value in an insurance policy provides means of paying for interest if owner becomes disabled, retires or leaves business.
- Serves to avoid family disputes.
- Avoids disruption of the business after an owner's death.

Buy-Sell Agreements can provide one of the most orderly means of transferring a business interest upon the death, disability, withdrawal or retirement of an owner. However, Buy-Sell Agreements must be funded to be of use. An agreement without a means to pay for the business owner's interest does not help anyone. Life insurance is one of the most cost-efficient and tax-efficient means to fund a Buy-Sell Agreement. All concepts, strategies and products discussed in this literature may not be suitable for every client.

DISADVANTAGES OF A BUY-SELL AGREEMENT

- The agreement must be funded to be effective.
- If insurance is used as the funding vehicle, premium payments must be made to keep the life insurance policy in force, otherwise the life insurance policy will lapse.

WHY SHOULD A BUY-SELL AGREEMENT BE REVIEWED?

- The value of every company changes yearly. In order to reflect an accurate transition if the Buy-Sell is implemented, an accurate valuation is needed to avoid challenges to the Buy-Sell Agreement's legitimacy.
- Goals may have changed since the initial implementation of the Buy-Sell Agreement.
- Life insurance product features have changed dramatically over the past several years, offering benefits which were previously unavailable, such as coverage for terminal, critical and chronic illness.

Is A Buy-Sell Review Needed?

Does the funding plan for your current Buy-Sell plan ...	Yes	No
... offer accelerated benefit options for terminal illness?	______	______
... offer accelerated benefit options for critical illness?	______	______
... offer accelerated benefit options for chronic illness?	______	______
... increase in value as your business value increases?	______	______
... pay an income tax-free lump sum at the death of an owner?	______	______
... offer to continue paying premiums automatically during a disability?	______	______
... offer a stream of income that may supplement retirement income of an owner?	______	______
... offer a stream of income to buy out an owner?	______	______
... reflect current ownership's goals and objectives?	______	______

If any of these questions were answered "no", talk to your agent about obtaining a no cost Buy-Sell Review.

Life Insurance – Accelerated Benefit Riders from ANICO™

Three great living benefits for NO ADDITIONAL PREMIUM[1]...

Critical – provides for the payment of an accelerated benefit if an eligible insured experiences a critical illness. Covered critical illness includes 16 Different Illnesses.[2]

Chronic – provides for the payment of an accelerated benefit if an eligible insured is unable to perform two out of six activities of daily living (2 of 6 ADLs [2]) or is cognitively impaired.

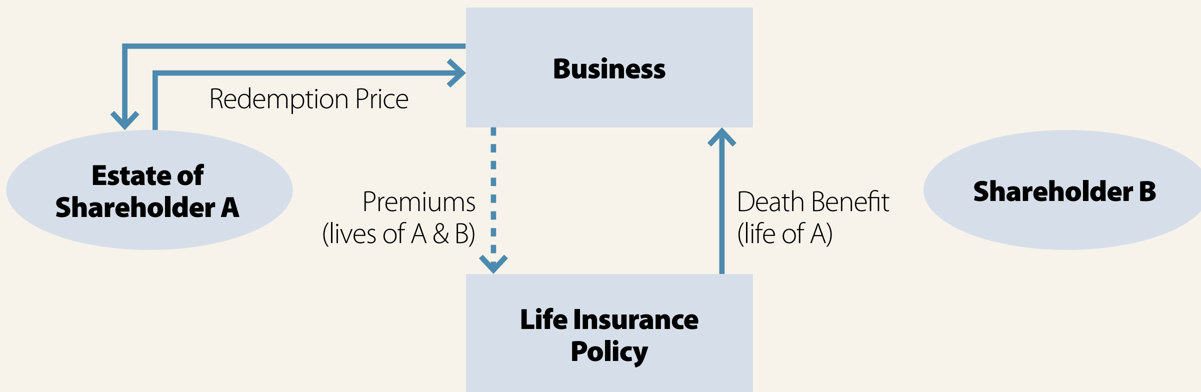
Terminal – provides for the payment of an accelerated benefit if an eligible insured has an illness or chronic condition that is expected to result in Death Within 24 Months.[2]

1. The Accelerated Benefit Riders are offered for no additional premium; however, the accelerated benefit payment will be less than the death benefit because it is paid prior to the death of the Insured and it is reduced by an administrative fee that is assessed when accelerated benefits are elected. Accessing living benefits may be a taxable event.
2. Refer to Rider forms for a complete list of illnesses and definitions. Some states may limit the definition of terminal illness to conditions that are expected to result in death within 12 months. All riders may not be available in all states. Policy Form Series ABR14-TM, ABR14-CH, ABR14-CT (Forms will vary by state).

May effect eligibility for state or federal benefits such as disability and medicare.

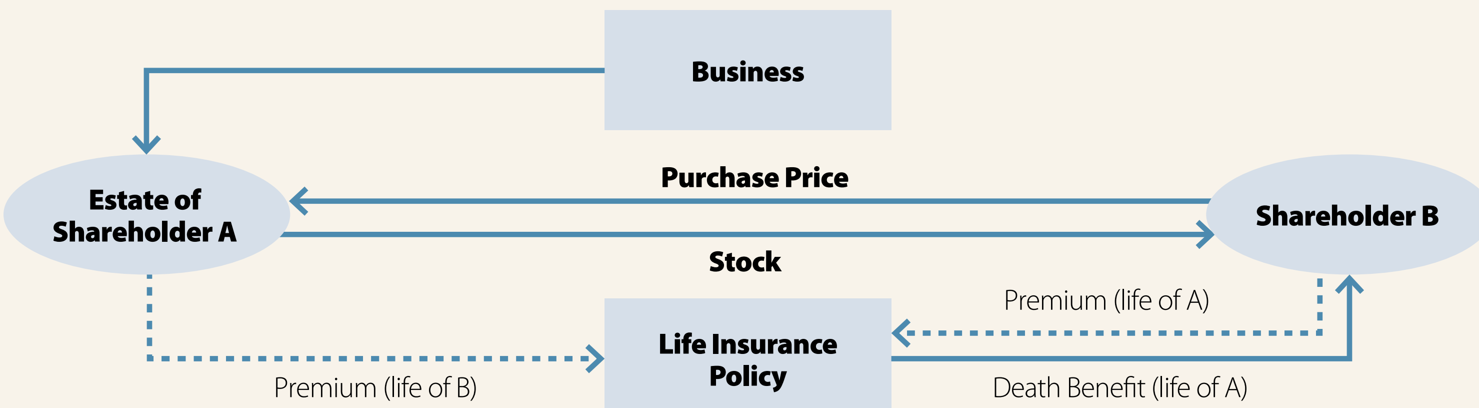
Access policy's death benefit while insured is still living ...

Types of Buy-Sell Agreements



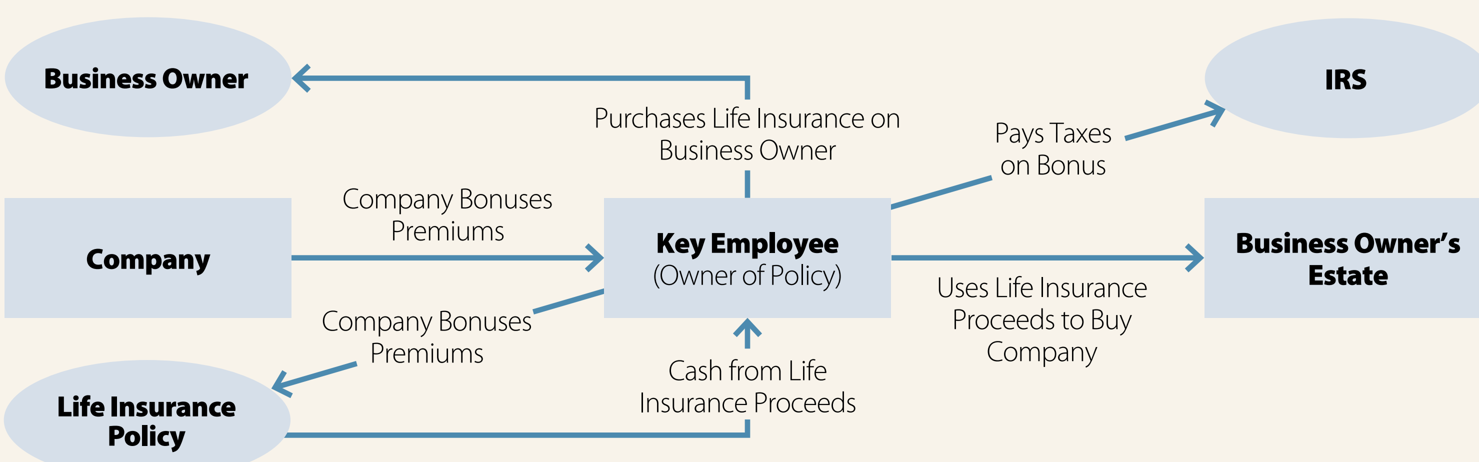
ENTITY PURCHASE BUY-SELL AGREEMENTS

An **Entity Purchase Buy-Sell Arrangement** (or "stock redemption arrangement") is an arrangement among the owners and the entity. The entity agrees to purchase (or redeem) all of the interest of a deceased owner and the owners agree to sell their interests to the entity.



CROSS PURCHASE BUY-SELL AGREEMENTS

In a **Cross-Purchase Buy-Sell Arrangement** the owners (or their estates) are obligated to sell their interests to each other. The entity is not a party to the arrangement.



ONE-WAY BUY-SELL AGREEMENTS

A One-Way Buy-Sell Arrangement is a type of a Buy-Sell Arrangement in which a valued employee, who may be a family member or a key person in the business, will purchase and own a life insurance policy on the life of the business owner. In this situation, because there is generally only one business owner and one designated successor, only one life insurance policy is required to fund the arrangement. The valued employee, who may be a family member or a colleague, will also be the beneficiary of the life insurance policy. The company will pay a bonus to the successor/policy owner in the amount of the premium payments annually to minimize the out-of-pocket expense of the arrangement. The bonus payments may be tax- deductible to the corporation when they are paid, but the payment will also be taxable to the recipient.

What Type of Coverage Should Be Purchased?

TERM LIFE INSURANCE

Term life insurance is pure insurance protection that pays a predetermined sum if the insured dies during a specified period of time. On the death of the insured, term insurance pays the face value of the policy to the named beneficiary. All premiums paid are used to cover the cost of insurance protection.

The term may be 1, 5, 10, 20 years or longer. But, unless renewed, the insurance coverage ends when the term of the policy expires. Since this is temporary insurance coverage, it is the least expensive to acquire. Here are the main characteristics of term life insurance:

- Temporary insurance protection.
- Low cost.
- No cash value.
- Level death benefit.
- Usually renewable.
- Sometimes convertible to permanent life insurance.

PERMANENT LIFE INSURANCE

Permanent life insurance provides lifetime insurance protection (does not expire), but the premiums must be paid on time. Most permanent policies offer a savings component combined with the insurance coverage. This component, in turn, causes premiums to be higher than those of term insurance. The savings component may offer a fixed interest rate or may be in the form of an indexed rate related to the performance of the S&P 500®.5 This savings portion of the policy allows the policy owner to build cash value within the policy which can be distributed at some time in the future.

Here are the main characteristics of permanent life insurance:

- Permanent insurance protection.
- More expensive to own.
- Builds cash value.
- May have increasing death benefit.
- Tax free loans are permitted against the policy.[3]
- Favorable tax treatment of policy earnings.[4]
- Level or flexible premiums.

For a comprehensive Buy-Sell solution, Permanent Life should be selected to enable the policy owner to utilize the cash value during retirement years as a buy out distribution to the retiring business owner.

3. Loans are subject to interest charges and can reduce the death benefit paid to beneficiaries. Outstanding loans may affect the policy's death benefit, the value of the policy and possibly the length of time the policy remains in force.
4. Neither American National nor its agents give legal or tax advice. Please contact your tax advisor or attorney regarding your specific situation.
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This brochure is not intended for use with California residents. Please see Form 10422-CA.

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Condensed Business
Fact Finder

AGENT INFORMATION

Agent Name | PC

Office Address

City/State/ZIP

Phone | Fax | E-mail

PRIMARY INFORMATION

Business Name

Address

City/State/ZIP

Interviewee | Position

LEGAL INFORMATION

Business Organization Type

❑ Corporation ❑ Partnership ❑ Sole Proprietorship ❑ Non-profit

❑ Sub-Charter ❑ Professional ❑ Limited Liability Corporation

How is the company taxed?

❑ C-Corp ❑ Partnership

Attorney | Attorney Location

Accountant | Accountant location

BUSINESS SUCCESSION

In the event of retirement, death or disability:

Have arrangements been made for who should control the business? ❑ Yes ❑ No

Do you have a plan to help with estate taxes and fees? ❑ Yes ❑ No

If you were to sell the business, what would the asking price be? $__________

To whom would you sell the business?__________

BUSINESS FINANCIAL DATA

Approximate business Net worth: $____________________

Annual before tax earnings: $____________________ 5-year average: $____________________

Federal Tax Bracket: ____________________% State Tax Bracket: ____________________%

Number of Owners: ____________________ Are any of them related? ❑ Yes ❑ No

Which owners are related? ____________________

Do any of the owners have a personal liability in the company? ❑ Yes ❑ No

Number of employees: ____________________ How many are key employees? ____________________

INSURED OWNER / KEY EMPLOYEES?

Insured: ____________________ ❑ Male ❑ Female

DOB: ____________________ State of Residence: __________ Status: ❑ Smoker ❑ Non-Smoker

Insurance Rating[1]: ❑ Preferred Plus ❑ Standard Plus ❑ Standard ❑ Table Rated ____________________

Is the employee an owner? ❑ Yes ❑ No Related to an owner? ❑ Yes ❑ No

If so, who?____________________

NEEDS, GOALS AND STRATEGIES

What are the company's fears and concerns regarding the future of their business?

What are their primary goals for the business?

How do they plan to achieve these goals?

What is the financial range of what they are willing to contribute to achieve these goals?

What would you, as the agent, like to be able to illustrate to the clients and business?

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1. Insurance Rating is assumed for illustration purposes only. All ratings are subject to underwriting approval.

Family Business Succession

Checklist

1. ESTABLISH GOALS AND OBJECTIVES

- ❏ Identify need for succession plan
- ❏ Establish personal retirement goals, including cash flow needs
- ❏ Identify family's goals
- ❏ Establish clear communication with family and company
- ❏ Establish team of personal advisors (CPA, attorney, etc.)

2. DECISION MAKING

- ❏ Involve family members in making decisions
- ❏ Establish plan to resolve issues
- ❏ Document succession plan
- ❏ Keep family and company aware of succession plan details
- ❏ Ensure all parties involved agree with potential plans

3. FAMILY ASSESSMENT

- ❏ Involve family members in making decisions
- ❏ Establish a training system for family members to join company
- ❏ Determine if all family members can communicate effectively
- ❏ Create rules for communication; violations could result in exclusion from discussions
- ❏ Clearly determine all family members' goals are in line with business plans
- ❏ Determine if there will always be a place for any family member who wants to work for the company

4. SUCCESSOR SELECTION

- ❏ Determine who is most qualified as successor – both managers and owners
- ❏ Clearly establish roles of all family members involved
- ❏ Identify areas of training needed by successors
- ❏ Establish training program for all successors for the future of the business
- ❏ Define role of current retiring owners/ management if they are to remain involved

5. CORPORATE STRUCTURE AND TRANSFER METHODS

- ❏ Determine if business is to be transferred or sold to family members
- ❏ Clearly define roles and responsibilities of family members and other key employees
- ❏ Determine if family members are capable of filling management positions
- ❏ Develop plan for hiring and retaining non-family members as managers
- ❏ Determine documents needed to create proper structure
- ❏ Determine how to fund transfer

6. BUSINESS VALUATION

- ❏ Determine value of assets and liabilities
- ❏ Consider what could be sold in the event of necessity
- ❏ Consider using business valuation experts to determine FMV for IRS purposes

7. EXIT STRATEGY

- ❏ Determine method of transfer
- ❏ Establish timeline for the implementation of the succession plan
- ❏ Publish the plan so all affected individuals are aware of coming changes
- ❏ Continue to maintain clear communication with all parties
- ❏ Review plan on a regular basis and update as necessary
- ❏ Consider sharing plan with lenders, suppliers, and key customers

8. PERSONAL ESTATE PLANNING

- ❏ Identify tax implications for owner and business upon sale/transfer of ownership
- ❏ Determine if estate has liquidity to pay taxes
- ❏ Determine retirement income needs
- ❏ Develop estate and personal financial plan for owner, spouse, and children
- ❏ Provide for active and non-active family members
- ❏ Complete wills, powers of attorney, and personal directives

9. CONTINGENCY PLANNING

- ❏ Identify potential problem areas
- ❏ Develop "What if" scenarios
- ❏ Develop action plans for all possible scenarios
- ❏ Continue to use plan to resolve issues and conflicts

10. LEGAL CONSIDERATIONS

- ❏ Develop financial objectives
- ❏ Be aware of current tax implications in business
- ❏ Plan and implement tax strategies to minimize taxes due
- ❏ Consider buy-sell agreement
- ❏ Ensure estate plan coordinates with buy-sell plan

11. MAINTAIN DOCUMENTS

- ❏ Wills and Trusts
- ❏ Power of Attorney
- ❏ Healthcare Power of Attorney
- ❏ Property deeds, leases, agreements, etc
- ❏ Life Insurance trusts and policies
- ❏ Mortgage and other bills
- ❏ Business succession Plan
- ❏ Buy-Sell agreements
- ❏ Tax records
- ❏ Bank Information
- ❏ Contact info of professional advisors (attorney, CPA, etc)

Non-Family Business Succession

Checklist

1. ESTABLISH GOALS AND OBJECTIVES

- ❑ Develop a vision statement for your business
- ❑ Develop a mission statement for your business
- ❑ Develop a list of your core values and guiding principles
- ❑ Develop short and long term goals for your business
- ❑ Identify the stakeholders for your business
- ❑ Develop your personal vision
- ❑ Develop your personal goals
- ❑ Develop your retirement goals
- ❑ Create a team of advisors for your succession planning effort
- ❑ Establish the need for a succession plan

2. EXIT STRATEGY

- ❑ Develop options for each owner's exit from the business
- ❑ Review the developed options for each owners exit from the business
- ❑ Select your option for your exit strategy

3. BUSINESS VALUATION

- ❑ Obtain professional advice to determine the value of your business
- ❑ Determine the value of your business
- ❑ Determine a current value of your business assets and liabilities
- ❑ Determine the goodwill value of your business

4. BUSINESS STRUCTURE

- ❑ Identify and quantify your business debt
- ❑ Recruit and retain productive employees
- ❑ Structure business to maximize value
- ❑ Document key processes and procedures used in your business

5. TAX CONSIDERATIONS

- ❑ Develop financial goals
- ❑ Identify tax implications of your current business
- ❑ Plan and implement tax strategy to minimize your taxes

6. LEGAL CONSIDERATIONS

- ❑ Retain professional legal counsel
- ❑ Develop a buy-sell agreement for your business

7. ESTATE PLANS

- ❑ Retain a professional estate planning advisor
- ❑ Develop an estate plan

8. SUCCESSOR SELECTION

- ❑ Develop specific criteria for your successor
- ❑ Recruit and select successor based upon your criteria
- ❑ Communicate selection of successor to your stakeholders

9. SUCCESSOR TRAINING

- ❑ Develop a list of characteristics and skills needed by your successor
- ❑ Develop a training plan for your successor
- ❑ Develop a coaching/mentoring plan for your successor
- ❑ Establish a timeline for your successor plan

10. CONTINGENCY PLAN

- ❑ Develop a contingency plan (based on the "What ifs?")
- ❑ Research and identify insurance needs (disability; personal life; critical illness; business; key person; etc.)
- ❑ Select and train a key employee to take over in case of emergency or unforeseen event.
- ❑ Communicate your plan to stakeholders and advisors

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11. IMPLEMENTATION PLAN

- ❏ Document the roles, responsibilities and expectations concerning the transition of ownership
- ❏ Identify a facilitator to make sure the process of succession is carried out

12. TIMELINES

- ❏ Identify your timeline for the management transition
- ❏ Identify your timeline for transition of ownership of your business
- ❏ Identify your timeline for your complete exit from your business

13. COMMUNICATION

- ❏ Document the succession plan
- ❏ Document how to proceed with the succession plan in the event of an unforeseen event (accident, illness, death)
- ❏ Document the transition or exit strategy to inform family, employees, clients, vendors, community, and all stakeholders

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Valuing a Business

The single biggest influence on the price an individual can get for their business is whether there is a demand for his/her business and whether there is an ample supply of similar businesses for sale i.e. supply and demand. If there are few sellers and many buyers, the price goes up. If there are many sellers and fewer buyers, the price goes down.

Generally, businesses are bought for what the business can do for the buyer. Does it complement their current business? Does the business expand the buyer's current market? Will there be cost savings as a result of the purchase? Will the business provide sufficient cash-flow to re-pay the initial purchase price? Will it provide the buyer a living and build for the future?

VALUATION METHODS ...

Valuing a business is an art, not a science. There are several ways to value a business. The more popular methods include:

- Asset Valuations: Calculates the value of all of the assets of a business and arrives at an appropriate price.
- Liquidation Value: Determines the value of the company's assets if it were forced to sell all of them in a short period of time (usually less than 12 months).
- Income Capitalization: Future income is calculated based upon historical data and a variety of assumptions.
- Income Multiple: The net income EBITA (Earnings Before Income Taxes and Amortization) of a business is subject to a certain multiple to arrive at a selling price.
- Rule of Thumb Method: The selling price of other "like" businesses is used as a multiple of cash flow or a percentage of revenue. Generally, asset based valuations do not work for small business purchases.

Assets are used to generate revenue and nothing more. If a business is asset rich but does not make much money, how much value does that business have? Conversely, if a business has limited assets but generates substantial cash flow, should it not be worth more?

Income capitalization is generally applicable to large businesses. The "Rule of Thumb" method is too general as it is difficult to find any two businesses that are exactly the same.

The multiple of earnings method represents the fairest way to value a small business. When purchasing a business, the seller wants a fair price for what they have built, but the buyer wants to know how much of a return on their investment they can expect to receive. The owner wants to maximize the selling price based upon past performance. The advantage of this methodology is that the value is based upon past performance and not future expected performance.

This is done by taking the businesses' profits plus the owner's salary and benefits and then adding back the non cash expenses. Then a multiple of this number is used to compute the value of the business. This is the most effective way to establish the value of a small business.

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THE FORMULA IS:

Pre-tax Profits + Owners Salary + Additional Owner Benefits + Interest
+ Depreciation - An Allowance For Capital Expenditures

Typically, a small business will sell in a one to four times multiple. The safety of the capital invested plays a part in what multiple to use. Many individuals want to see a 25% return when taking on such a risk. Another consideration is "what is the business worth to the buyer?" Is there a synergy that can take place through the purchase such as a desire to break into a new market without going through the start-up process? A business may be worth more to the buyer if such a synergy can exist.

Other factors that influence the value of a business include:

- Recent profit history
- General condition of the business
- Market demand for particular type of business and its products and services
- Return on investment
- Cash Flow to support loan
- Strategic value
- Licenses that would not have to be applied for as in a new business
- Economic conditions including availability of capital
- Ability to transfer goodwill to new owners
- Value of underlying assets
- Future profit potential

A successful business will generate sufficient profit to provide a fair income to the owners, a reasonable return on capital invested, the recovery of invested capital and repayment of borrowed capital. All of these factors along with what a willing buyer will pay to purchase a business from a willing seller go into the final price of a business.

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