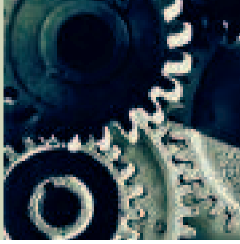
Business Planning

Business Continuation

Life's Commitments



You've worked hard to build a successful business. Have you worked as hard to protect it from these risks?

- Death
- Disability
- Losing a key employee

These are concerns common to most business owners as they move through the different phases that nearly all businesses experience. Those phases include:

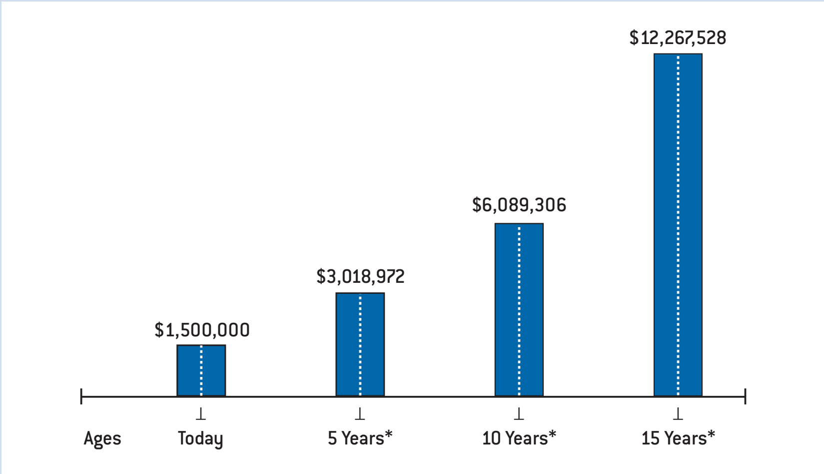
- Start-up
- Growth
- Maturation
- Transfer

Knowing where you are in this cycle will help you determine your goals and objectives.

A key consideration in planning for the success of your business is understanding its value. What is your business worth?

What will it be worth in 5, 10 or even 15 years?

Business Valuation



*This hypothetical scenerio assumes a 15% annual growth of the business.

You've built your business.

Your business is successful. Your customers are happy. Your family is enjoying a comfortable lifestyle. And years of hard work are finally paying off.

- So, what would happen if you were suddenly disabled?
- Or, if you died unexpectedly?
- Or, if you simply decided it's time to retire?

Without proper planning – planning for the continuation of your business without you – your lifetime of achievement could be exposed to potentially devastating problems.

- Customers who do business with you, because of you, could go elsewhere.
- Key employees could start looking for other opportunities.
- Family members or business partners could begin disagreeing over "who gets what" and who should make day-to-day business decisions.

The possible results...

- A potential shortage of cash, especially following death.
- Difficulty paying debts.
- Inadequate income for you, your spouse and your heirs.
- The liquidation of assets and ultimately, your company, to pay federal and state taxes.
- Insufficient retirement income.
- Inequitable treatment of heirs.
- Estate erosion.
- Failure of the business.

With proper business continuation planning, you can help ensure that your business, and the people whose incomes and lives depend upon it, will succeed when you're no longer at the helm.

Have you completed a valuation of your business? When? Did you factor in the effects of inflation?

There are several methods of valuing your business, but the sample worksheet below may help to give you an idea of what your business is worth.

Sample Business Valuation Worksheet

Average Annual Earnings[1]	$________
Divided by Capitalization Rate[2]	$________
Equals Total Capitalized Earnings	$________
Plus Fair Market Value of Assets	$________
Equals Total Gross Value of Business	$________
Minus Total Liabilities	$________
Equals Estimated Net Value of Business	$________

[1] Average after-tax earnings, including all compensation of owners.

[2] Lower capitalization rate indicates lower business risk - higher capitalization rate indicates higher business risk. Normal range is 10% (.10) to 30% (.30).

What is business continuation planning?

Simply, business continuation planning is developing – and then implementing – a plan of succession. Usually called a "buy-sell" agreement, proper business continuation planning answers the question: Who will take over my business should I die prematurely, become disabled, or simply decide to retire?

If you're a business owner and you don't have a buy-sell agreement, you may not have planned sufficiently for the future.

Depending upon how your business is owned, a buy-sell agreement can be established between:

- You and your partners.
- Your business and its owners.
- You and other family members.
- You and a key employee or employees.

A properly structured buy-sell agreement will:

- Pre-determine who will receive your business.
- Set the purchase price and terms of payment.
- Establish the value of your business for federal tax purposes.
- Specify how the transfer will be funded.
- Provide the cash needed to pay federal and state death taxes, debts, and other estate settlement costs.

The time for planning is now...

Nearly 70% of small businesses don't make it to the next generation, and 85% don't survive to the 3rd generation.

U.S. Small Business Association (2006)

A properly funded buy-sell agreement will address potential problems before they arise by providing:

- **Estate liquidity** – to help pay federal and state taxes, debts, and probate expenses.
- **A source of income** – money you and/or your family can use to maintain your lifestyle.
- **A known purchaser and a set price** – for the sale and purchase of your or your partners' business interests.
- **Tax valuation** – the value of the business, or the share being transferred, is established for federal tax purposes.
- **Successor ownership and management** – so the business can continue without interruption or outside interference.
- **A funding vehicle** – to provide retirement income.
- **Improved relationships** – not only with business partners and family members, but also with business creditors.

How do you know what your business is worth?

So what are your options?

There are basically three types of buy-sell agreements:

- An entity buy-sell agreement, where the business entity agrees to purchase the interests of the individual owners.
- A cross-purchase buy-sell agreement, where the individual owners all agree to purchase the interests of the other owners.
- A "wait and see" buy-sell agreement, where the stockholders and the business agree that either the individual stockholders or the business will have the first option to buy the interests of the other owners, depending on which is most advantageous.

A fourth type of buy-sell agreement deals with the disposition of a business following the total disability of a business owner. A disability buy-sell agreement can be set up as either an entity or cross-purchase plan.

Life’s Commitments

Consider the following real-life IRS challenges to what these individual business owners thought their businesses were worth:

No buy-sell agreement

These business owners had no buy-sell agreement. When they died, the IRS challenged what their estate claimed it was worth.

Estate of Harry S. Leyman
Auto Dealer

Estate’s estimate of the business’ value per share: $536

The IRS value per share: $700

Court decision: $630

Estate of Edward E. Hansoom
Real Estate Developer

Estate’s estimate of the business’ value per share: $50

The IRS value per share: $100

Court decision: $100

Buy-sell agreement

These business owners did have a buy-sell agreement. Look at the difference in estate settlement.

Estate of John T.H. Mitchell
Advertising Agency

Buy-sell agreement value per share: $123

The IRS value per share: $349

Court decision: $123

Estate of Slocum vs. US
Hospital

Buy-sell agreement value per share: $100

The IRS value per share: $1,109

Court decision: $100

Note: These results are based on specific cases that may or may not be representative of other situations and cases.

BUSINESS PLANNING

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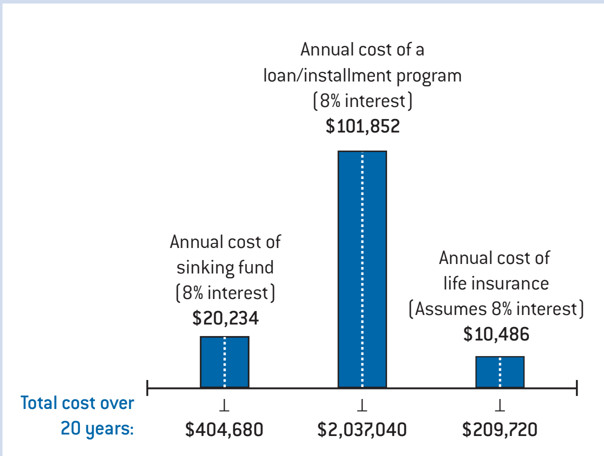
A properly drafted buy-sell agreement could save you, your company and your heirs thousands of dollars and ensure that your assets are passed on quickly and without delay.

Do you have a buy-sell agreement? When did you last update it?

What are the funding alternatives for buy-sell agreements?

- **Business Cash** – taking cash from the business to fund a buy-sell requires that large sums of money be readily available. Does your business keep a large supply of cash on hand at all times?
- **Sinking Fund** – if the need for money to fund the plan occurs in the near future, there may not be adequate funds available. Are you willing to take that risk?
- **Borrowed Funds** – you could borrow the money needed to fund the agreement, but you'd have to pay interest on it. And what happens if the loss of a key employee causes your credit rating to slip?
- **Installment Payments** – you could buy out the departed owner's interest in installments, but, as with borrowed funds, the company would still be paying both principal and interest. What's more, your spouse and heirs would be dependent upon the successful continuance of the business to receive payments.

Compare the annual cost over 20 years of purchasing a $1 million business interest:



*The performance information represented is based on hypothetical valuations for a male, age 45, standard non-tobacco, 20-pay premium to endow the policy at age 100, and is for illustrative purposes only. Actual cost will vary.

- **Life and Disability Insurance** – an advantageous and affordable alternative is with insurance:
  - – Financing is guaranteed[1] – whenever it is needed.
  - – Proceeds are generally exempt from income taxation.
  - – Cash values[2] can be used for a buy-out due to retirement or disability.
  - – The credit position of the business is strengthened.

[1]Based on the claims-paying ability of the issuer.

[2]Certain limitations may apply to loans or withdrawals. Policy loans and withdrawals will reduce the death benefit and cash values, and may be taxable under certain circumstances.

Life's Commitments

Do I really need a buy-sell now?

The chance that you, a partner or family member could die or become disabled is not remote. Add a second or third owner, and the need for a buy-sell agreement becomes even greater.

The following chart indicates the odds of at least one death occuring before age 65 to any one person out of one, two, or three persons.

Chances of death occurring prior to age 65

Age of each person	To any one person	To any one person out of any two people	To any one person out of any three people
30	14.9%	27.6%	38.4%
35	14.4%	26.7%	37.3%
40	13.8%	25.7%	36.0%
45	13.0%	24.2%	34.1%
50	11.6%	21.8%	30.9%

Souce: 2007 Field Guide. National Underwriter Company.
Assumes all individuals are male and the same age.

Finally...

Ensuring the continuation of your business with a properly drafted buy-sell agreement will provide more than just a mechanism for transferring the business should you die or become disabled. It can also save you thousands of dollars – and hours – by eliminating the potential costs, delays and frustration of IRS contests and litigation.

When properly drafted, a buy-sell agreement will establish the value of a business for the purposes of federal estate and gift taxes. But in order to do so, the agreement must first meet three requirements:

- It must be a genuine business arrangement.
- It must not be a device to pass the business interest to family members for less than full value.
- It must be comparable to similar arrangements entered into by other persons in an "arms length" transaction.

It's never too early to think about planning for the orderly and affordable continuation of your business. And the sooner you start, the more affordable it will be.

Life's Commitments

A secure financial future doesn't happen by accident.

It requires:

- Examining your current circumstances
- Identifying your goals and objectives
- Developing a plan to help achieve those goals and objectives
- Taking action to implement your plan
- Periodically reviewing your plan.

The tool that helps us gather the appropriate information to begin this planning process is referred to as a fact finder, simply a series of questions specific to your unique situation. You can rest assured that all the information you provide will remain strictly confidential. Once we have a good understanding of your current situation we will be better prepared to serve your needs now and in the future.

Together, we'll develop the steps you can begin taking immediately to help secure your financial future.

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