Business Continuation Planning Report

Preparing for the unknown future of your business

Presented to

Sample Entity Purchase Proposal

Presented by

Principal Financial Group

Not FDIC or NCUA insured
May lose value • Not a deposit • No bank or credit union guarantee Not insured by any Federal government agency

Protect your success

You can be proud of the business you've built and its success. You've worked hard, so you want to make sure that the business plans you have for the future can be realized.

There are three key components to effective planning:

1 | **Knowing the value of your business.**

2 | **Protecting your business and your key employees.** Business succession and business protection plans allow you to prepare for the unexpected, as well as the future success of your business. And, retention and retirement solutions can also help you and your valuable key employees.

3 | **Protecting your lifestyle.** Retirement, income protection and legacy and estate planning solutions help you and your family maintain your lifestyle.

That may sound like a lot to think about. But, that's where Principal® comes in. We're here to help you implement proper business planning, and to offer simple processes to help keep those plans current.

So what's the first step?

Because the value of your business is such an integral part of effective planning, understanding the value might be a great place to start. You probably have a good idea of what your business is worth. But, if you're like a lot of other business owners, you may not have ever had your business valued. So, an informal business valuation might help you get started towards protecting your business' future success.

Ask your financial professional about getting a complimentary informal business valuation from Principal®.

We can also also help you with the rest

The content in this report is primarily intended to help you with the protection aspect of the planning process—protecting your business, your key employees and your lifestyle.

- **Protecting your business and key employee.** An important part of planning for the future includes having a formal business succession plan in place. It's the best way to help ensure that your business will continue in your absence, and on your terms. This is something many business owners don't address. In fact, 44% of growing businesses don't have an exit or continuation plan in place.[1]

  Even though the top two transition events identified in a buy-sell agreement for businesses are death and disability of an owner, many buy-sell agreements we've reviewed fail to make these triggers "mandatory" events. Death is a mandatory buy-out event for 71% of agreements. But for disability, that percentage drops to only 34%.[2]

- **Protecting your lifestyle.** Protecting the value of your business is also key. It's important to your company's overall success should something unexpected happen. You also want to protect the business because it's likely a source of income for you and your family, as well as planned retirement income for you. We know this type of planning is easy to overlook. That's why we've identified some planning solutions to help you get started.

This comprehensive report is meant to be a planning guide for the long-term future of your business. We'll start by overviewing why knowing the value of your business is so important. Then we'll highlight possible solutions and next steps needed to create effective plans specifically designed to suit the needs of your business. And, knowing you probably can't do everything at once, we'll help you prioritize your next steps and get the planning process started.

We look forward to working with you to put a plan in place that will help ensure your business will meet the goals you have set, and that will help it thrive under many contingencies.

[1] 2019 Principal Financial Group® Business Owner Survey, conducted by Harris Insights & Analytics.
[2] Review of 1,561 buy-sell reviews by Principal Financial Group (1/01/2014 to 1/31/2018).

Know the value of your business

Determining the value of your business is the starting point and an integral part of the planning process. There are many different methods to value a business, but there's no one method that's always appropriate. At the end of the day, the "fair market value" of a business is the amount agreed upon by a willing buyer and a willing seller. Neither party is under any compulsion to buy or sell, and both must have reasonable knowledge of all the relevant facts. This is a common definition used for valuing a business, but we'll try to add a little more clarity to it below.

Valuation approaches and methods

Business valuation methods are generally categorized under three approaches: asset approach, income approach, and market approach. Since no single method is most appropriate for valuing every business, it's common to reference a business valuation method under any one or all three approaches.

Asset approach

This is typically used with businesses that have substantial tangible assets, usually in the form of inventory and equipment. It's most appropriate for businesses with a substantial amount of fixed assets.

Adjusted book value – This generally represents the "liquidation" value – assets, with adjustments, less liabilities.

Income approach

This type of approach uses prior earnings to estimate company value based on income potential. It's most appropriate for businesses with consistently strong earnings. Specific methods include the following:

Capitalization of earnings method – Applicable for consulting-type businesses and/or those with few or no tangible assets.

Excess of earnings method – Generally for manufacturing-based firms with significant assets.

Discounted cash flow method – Uses projected values. Projected future earnings are forecast, then discounted using an appropriate rate representative of the "next best investment opportunity" with a comparable level of risk. Used mainly for mergers and acquisitions.

Multiple of discretionary earnings method – Applicable for more service-oriented firms, such as legal, accounting, healthcare systems, dental, engineering, etc. Goodwill of the owner(s) has a significant impact on value.

Market approach

This is based on the prices of similar or comparable businesses that have recently sold. This data is more challenging to find for the sale of small businesses and professional practices, rather than for large businesses. **A valuation using this method is not provided in this report.**

Considerations for valuing a business per IRS Revenue Ruling 59-60

- Nature and history of business
- Outlook of the economy and the specific industry
- Financial condition of the business and its book value
- Earnings capacity of the company
- Nature and value of any intangible assets of the business, such as goodwill
- Relative size and block of the business interest to be valued and any prior sales
- Market price of actively traded stock of corporations in the same or similar business

Plan now for a successful transition

It’s easy to think that you’ll have plenty of time to prepare for a transition in business ownership. But time can go by faster than you think. There are many events—both planned and unplanned—that could change the business, like the retirement, dissolution, death, disability, divorce, or termination of an owner. Unfortunately, these events happen more frequently than you might think.

Don’t let an unplanned event (or even a planned one) sideline the business you’ve worked so hard to build. Now is the time to protect its future and those who depend on it. There are many succession strategies to consider. It’s best to start with your goals which can generally be boiled down to three questions:

Who – To whom will you transfer the business?

Timing – When do you plan to transition out of your business?

Funding – What will it take to generate the income you need for estate liquidity, succession strategies, and replacement income after your working years?

So, let’s start with the first question. Then we can help you explore specific solutions, timing, and funding options from there.

Protect your business with a buy-sell agreement

A properly funded and current buy-sell agreement helps business owners make sure they have the right amount of money, in the right place, at the right time.

With a little coaching from Principal, you can design a buy-sell agreement which does the following:

- Provides departing owners a market and price for an asset that might otherwise be hard to sell.
- Prevents an unqualified or undesirable individual from acquiring an interest in the business.
- Minimizes business disruptions at various triggering events.
- Provides assurances to employees, customers, suppliers and creditors that the business will remain strong through owner transitions.
- Provides both the financing and the mechanism to ensure that control of the business will remain with the current owners (when funded with insurance).

Important features of a buy-sell agreement

- › Firm buy-sell commitments
- › A comprehensive list of clearly defined triggering events
- › Funding that's consistent with plan design
- › A clearly designated or defined purchase price
- › Clear, realistic payment terms
- › Language addressing purchase options for life and/or disability income insurance policies

Your company profile

Entity type:	S Corporation	Number of employees:	11-50
Family business:	No	Number of business owners:	3
State:	IA	Number of children active in business:	0
Industry:	Construction	Number of children not active in business:	0
Industry sub type:	Not available	Years in business:	15

Business ownership

Owner	Ownership %	Assumed value today	Estimated future value[1]
Jesse Jones	50.00%	$3,000,000	$4,014,676
Kelly Johnson	25.00%	$1,500,000	$2,007,338
Pat Smith	25.00%	$1,500,000	$2,007,338

[1] Estimated future value is based on a 6.0% growth rate and 5 year(s) in the future.

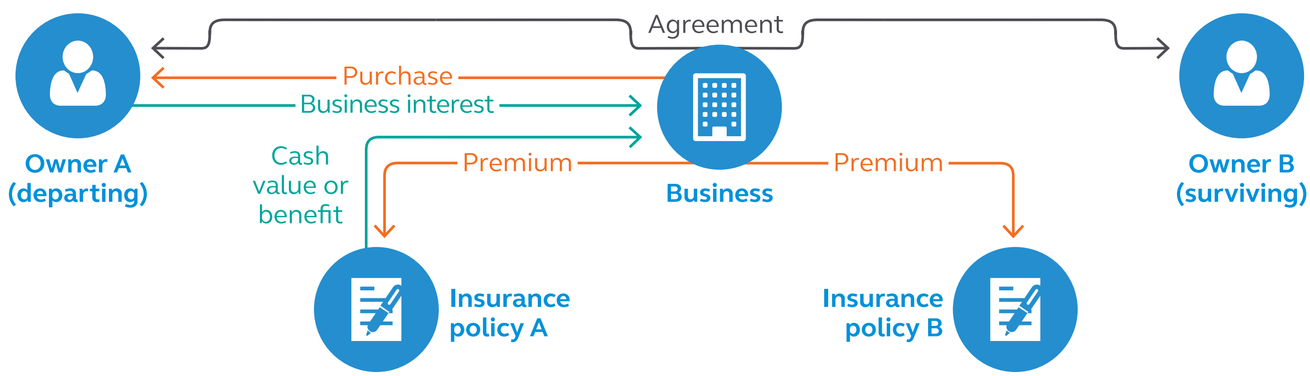
You may want to consider the following business succession solutions.

Entity purchase buy-sell agreement

An entity purchase buy-sell agreement can help protect the future of your business. It arranges for the business (rather than the other owners) to purchase a departing owner's interest. The purchase can be triggered by death, disability, divorce, retirement, or other events.

Here's how it works

Once the agreement is in place, the business purchases a life and/or disability insurance policy on each owner. The business is the owner, premium payer, and beneficiary of those policies. Upon the triggering event, the business purchases the departing owner's business interest using policy cash values or benefits from the policy.



What you need to know

There are advantages to this sort of an agreement, just as there are some other things to consider.

Fewer policies are needed – The business owns and pays premium on one policy per owner.

Remaining owners may pay higher taxes later – Since the remaining owners don't purchase the departing owner's shares directly, they might not receive a full increase in basis, depending on the structure of the business.

Family-owned businesses may require additional planning – If departing owner's family members remain owners, special planning may be necessary.

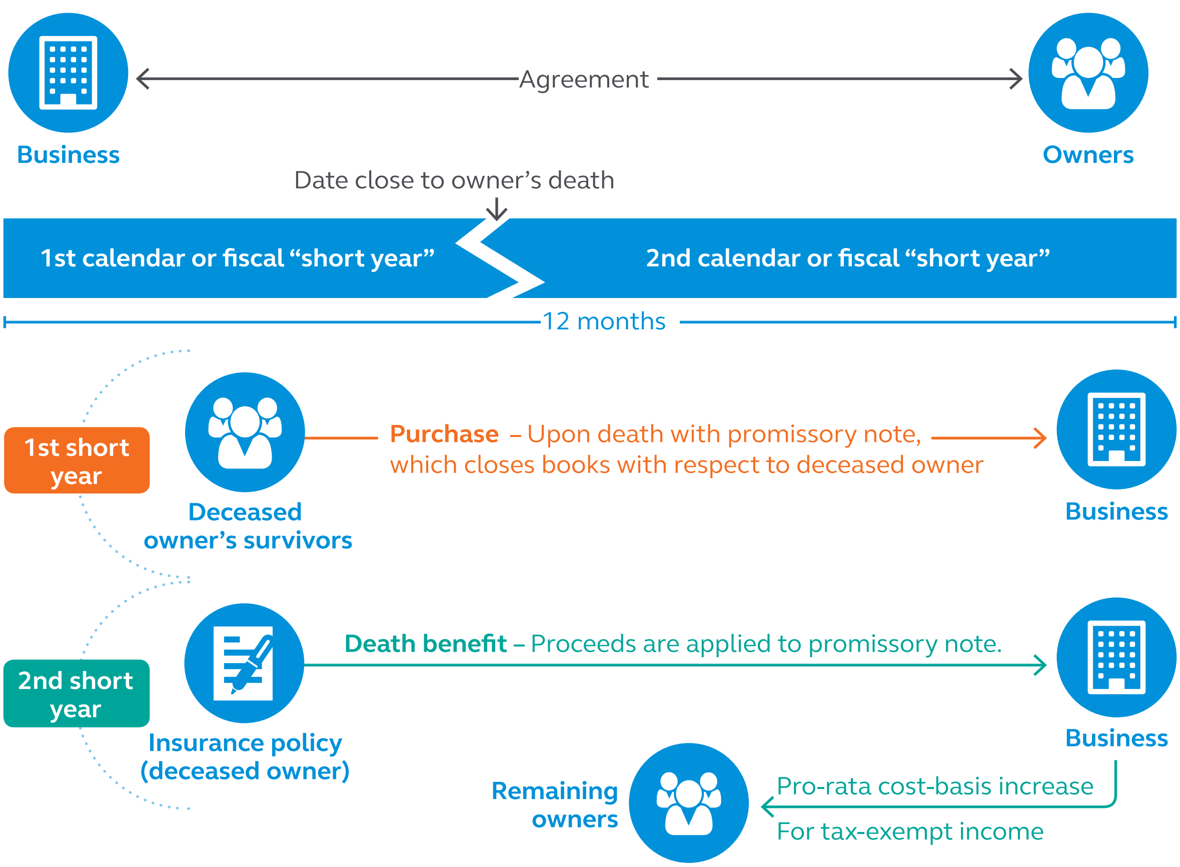
Tax implications can vary by triggering event – Family members generally receive an adjusted basis following an owner's death. For disability or other lifetime triggering events, the selling owner may recognize capital gain.

Short-year election

A short-year election is a special provision in the Internal Revenue Code (IRC) that may help protect the future of select S corporations. For those companies that use the cash-basis accounting method for tax purposes, this can be a good fit. It takes an entity purchase buy-sell agreement and amends it to require an IRC Section 1377(a)(2) short-year election upon the death of a business owner.

Here's how it works

Once an entity purchase buy-sell agreement is in place, the business purchases a life insurance policy on each owner. Upon the death of one owner, the remaining owners elect to split the current fiscal year into two short years. The first short year generally ends on a date closely following the owner's death, when the stock is redeemed from the estate. The second short year opens the next day and ends at regular year end.



What you need to know

There are advantages to this sort of an agreement, just as there are some other things to consider.

Fewer policies are needed – The business owns and pays premium on one policy per owner.

Business faces tax implications prior to death – Premiums aren't deductible and reduce cost basis in the business, pro rata (to the extent a cash value increase doesn't offset cost basis reduction from the premium payment).

Business receives a tax-free death benefit – Business receives death proceeds from the life insurance policy on the deceased owner (assuming compliance with IRC Section 101(j)).

Remaining owners receive tax benefits upon a subsequent sale – They receive an increase in cost basis in the business, pro rata.

Deceased owner's survivors benefit – Unnecessary cost basis increase for the deceased owner is avoided and no capital gains tax will be due, since the sale price will likely be adjusted cost basis.

How to fund a buy-sell agreement

Buy-sell agreements involve the selling and buying of the departing owner's business interests according to the terms of the formal agreement. This means money will be needed to complete the transaction when it occurs. So, it's best to have a plan for securing that money. There are basically five options for this.

Funding methods

Cash – Requires sufficient cash flow to pay the full price in a lump sum.

Loan – Involves unknown factors such as future credit availability and cost of borrowing. Borrowed funds must be repaid (with interest) from earnings. A down payment is generally required.

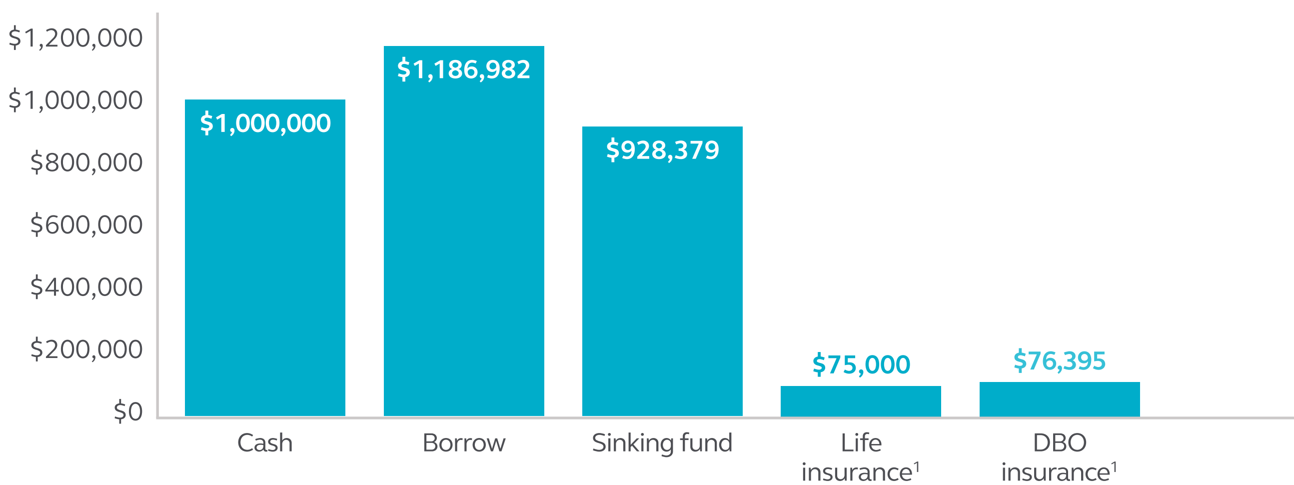
Savings – Doesn't assure that sufficient funds will be available when needed because of unpredictable departure timing.

Installment sale – Requires repayment from earnings and is contingent on future success of the business.

Insurance – Provides liquidity when purchased upon the implementation of an agreement. Since the death or disability of an owner is often unpredictable and disruptive to a business, each is typically a mandatory triggering event in a buy-sell agreement.

How do you decide which method is appropriate for your situation? Timing of liquidity and cost are typically the key considerations. Compare these hypothetical protection costs for a $1,000,000 purchase price.

Hypothetical funding method cost at end of 15 years



Assumptions:

Cash	$1,000,000
Borrow	Represents five equal annual payments of $200,000 plus interest at 6%.
Sinking fund & cash	Sinking fund of $146,621 (annual deposits equal to the life insurance premiums growing at 8%) plus the balance necessary of $853,379 in cash.
Insurance	**Life –** Estimated premiums of $5,000 for Male, 45, Preferred, Non-tobacco, UL Flex III policy. **Disability Buy-Out (DBO) –** estimated premiums of $5,093 for Male, 45, Executive Occupation class DBO policy. Insurance premiums paid for 15 years. Not valid without accompanying insurance illustrations. See illustrations for important information.

[1]The amount of insurance available to purchase depends upon the value of the business. Underwriting standards for life insurance and disability coverage are different. Disability buy-out insurance may not be available for every business.

Protect your business from the loss of a key employee

In the event of a death, disability or resignation of a key employee, would your business be as successful as it is today? A business protection plan can help you prepare for the unexpected and lessen the impact of such a loss. Unfortunately, **only 46% of business owners have a business protection plan in place[1],** leaving them exposed to risk.

A business protection strategy can lower the risk. It allows you to implement a financial cushion, with cost- effective liquidity, which can help replace and/or retain key employees who critically impact the value of your business.

Are business protection solutions right for your business?

Before moving forward with a strategy, an important first step is to ask "Who exactly are my key employees?" Think about the employees in your organization who really make a difference. Consider the areas of operations, workflow, relationship management, customer relations, sales, and profitability.

Then, think about these questions:

Yes No

- ◯ ◯ Would your business be negatively impacted by the **loss of a key employee**?
- ◯ ◯ Are you interested in developing special incentives to **tie your key employees to the business** for the long term?
- ◯ ◯ Would your key employees like to **save more money** on a tax-advantaged basis?

If you answered yes to any of these questions, you can implement simple strategies to help. There are generally two types of solutions: **key person protection** and **key employee benefits**.

Key person protection

Protect the integrity, cash flow and ongoing success of your business from the loss of a key employee due to death, disability, or termination of employment. Key person insurance helps the business overcome additional expenses associated with recruiting and training a replacement.

[1] 2019 Principal Financial Group® Business Owner Survey, conducted by Harris Insights & Analytics.

Key employee benefits

Recruit, reward, retain and retire the key employees with key employee benefit plans. These plans can help you by helping them. They can provide additional benefits and/or help them make up for benefits lost due to government restrictions placed on qualified retirement plans. The result? More engaged and loyal employees and a great recruiting tool, too.

Specifically, these plans can do the following:

- Enhance your total benefits package by offering a financial reward.
- Encourage loyalty by helping to secure their financial futures.
- Give key employees an incentive to grow the business.
- Provide simplified government reporting and disclosure rules—or none at all.

Considerations for common key employee benefit plans

Business considerations	Principal® Bonus	Principal® Deferred Compensation - SERP	Principal® Deferred Compensation - Select Reward	Principal® Deferred Compensation - Defined Contribution	Principal® Loan Split Dollar
Immediate tax deduction	Yes	No	No	No	No
Golden handcuffs	Limited	Yes	Yes	Yes	Yes
Cost recovery	No	Yes	Yes	Yes	Yes
Administrative services	Yes	Yes	Yes	Yes	Yes
Employer contributions	Yes	Yes	Yes	Yes	Yes
Employee contributions	Yes	No	No	Yes	No

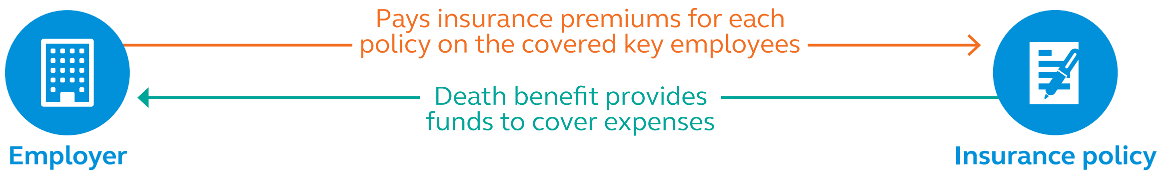
Key person life insurance

The most valuable assets of any business are often the key people who contribute most to its success. They generate revenue, handle major responsibilities, and have a unique wealth of knowledge that seems irreplaceable.

Have you considered the amount of time and money it would take to replace your top talent? If their loss would create a financial burden that puts the business at risk, a key person insurance policy can be a simple and efficient solution.

Here's how it works

Your business is the owner and beneficiary of a life insurance policy for each key employee chosen, which can include business owners. If the unexpected does happen, the business receives cash, generally income tax-free, to help overcome the financial challenges of the loss.



What you need to know

There are advantages to this sort of an arrangement, just as there are some other things to consider.

Immediate cash – So you don't have to worry about how you will pay for the loss and replacement of a key employee.

Cost efficiency – Affordable term or permanent policies may provide significant death benefits.

Cash value potential with permanent policy option – Potential cash values can remain an asset on your balance sheet or be used for other expenses, such as a key employee benefit program.

What's right for you – There are several insurance and funding options. Carefully decide what is best for your business.

Effect on your assets – Understand how significant life insurance policy holdings will affect your capital and liquidity.

Employee retention – If keeping your key employees is a concern, consider a retention bonus plan that allows you flexibility as well as funding to protect your most valued employees under multiple scenarios.

Protect your income and your business

Individual disability insurance protects your income and business against life's uncertainties so you can avoid dipping into savings or retirement assets if you're too sick or hurt to work.

Consider the **four key areas** that can be impacted by a disabling event.

Income protection/ benefit planning

How will you pay the bills if you become too sick or hurt to work? Do you offer employees group long-term disability (LTD) insurance? Do you offer special benefits to retain/reward your key employees?

Individual disability income insurance benefits:

- Helps replace a portion of your income lost due to a prolonged illness or injury.
- Helps maintain your lifestyle without draining savings or business profits.
- Provides a valuable employee benefit.

Retirement savings

Would you or your key employees still be able to save for retirement if you could no longer work due to a disability?

DI retirement security benefit:

- Helps you continue to save for retirement since often 401(k) (and employer match), Social Security and pension plan contributions stop if you can't work.

Business protection

How will you pay business loans and expenses if an owner becomes too sick or hurt to work? What will you do if a key employee can't work due to a disabling illness or injury?

Three solutions offer protection:

- **Overhead expense insurance –** Reimburses you for fixed business expenses.
- **Business loan protection[2] –** Provides payments to help cover the cost of a business-related loan obligation.
- **Key person replacement insurance[3] –** Provides benefits to the business in the event an insured key employee becomes totally disabled.

Business succession planning

If you have a buy-sell agreement, is it funded if an owner becomes disabled?

Disability buy-out insurance funds a buy-sell agreement if an owner becomes totally disabled. Benefits for you and your partners:

- Maximize the financial return when the business is transferred, while minimizing tax liability.
- Help the business survive a partner's departure, allowing remaining owner(s) and their family(ies) to receive the full value of the business.

[1] DI retirement security is issued as a non-cancelable, guaranteed renewable, individual disability income insurance policy. It is not a pension or retirement program or a substitute for such a program. DI retirement security is not available for government employees or anyone who is over insured based on Principal Life's current Issue and Participation guidelines. It may not be available or the benefit amount may be reduced for certain occupations if there is existing DI coverage with lifetime benefits. Additional underwriting guidelines may apply.

[2] Available as a rider on an overhead expense insurance policy. Not available in all states. Visit principal.com/distateapprovals to learn more.

[3] Benefits cannot be given to the key employee.

Plan services that make things easier for you

It takes a lot of work to run a company, to say the least. And, we understand you may not have time to think about business transfer strategies, employee retention programs, or retirement planning. That's okay. That's why we're here.

How do you get started?

Together with your financial professional, Principal will help you identify the right solutions for your organization, then work with you to implement them properly. Staffed with attorneys, CPAs, and plan design specialists, our Business and Advanced Solutions team is ready to assist you with design consultation and sample plan documents. But, we don't stop there.

Your needs may change. Regulations may change. We can help you keep up with both.

You don't have to take care of the ongoing management of your plan all by yourself. Our Business Market Administration team provides dedicated, ongoing support for your employer-owned and employer-sponsored plans funded with life insurance. And we'll be there not just today, but throughout the life of your plan.

Administrative services

Plan-level consulting – Reviews your specific needs, then helps you design, implement and administer an effective plan.

Dedicated administrator – Personally assists you with enrollments, policy adjustments, service requests, policy illustrations, and more.

Plan-level reporting – Makes participant communications and any needed tax reporting easier. Consolidated reports show current coverage amounts, policy values, and premium information for all participants with life policies under your plan.

List billing – Delivers consolidated payment reminders covering all policies under your plan—billed annually, semiannually, quarterly or monthly.

Online access – Allows you to view policy information 24/7. Policy owners may also make changes or initiate service requests.

Supporting you every step of the way

Your customized planning considerations

We're here to help you achieve your goals. We understand that some of your goals are more important to you than others. So, review each planning area, prioritize what's most important to you and your business, and complete the action items below based on your priorities.

Business succession planning	Priority ranking	Target date
Know the value of your business – Understanding the value of your business is an integral part of the planning process. And, as there are many different methods to value a business, there is really no one method that's always appropriate for every business. So, obtaining a value that may be consistent with the value you need to protect, is a great start. Principal® offers a complimentary informal business valuations for certain businesses. ☐ Request a proposal		
Business succession planning – In order to help you successfully transition out of your business, numerous buy-sell and transfer strategies are available. Principal can consult with you to identify a solution best suited to your unique needs and company characteristics. ☐ Request a proposal		
Buy-sell agreement – Businesses with two or more owners need a buy-sell agreement fully funded with life and disability insurance. If you don't have one, you may want to consider implementing one. If one already is in place, a complimentary buy-sell review could be conducted by Principal. ☐ Request a proposal and sample agreement O An entity purchase buy-sell agreement O A short-year election ☐ Request a review of your existing buy-sell agreement		
Buy-sell agreement funding – A properly funded and well-drafted agreement that reflects your goals and objectives can protect you during both planned and unplanned events. Do you have adequate funding in place? ☐ Review existing funding ☐ Request a life insurance funding illustration ☐ Request a disability insurance funding illustration		

Business and key employee protection	Priority ranking	Target date
Key person life insurance – It's likely that your business relies heavily upon the talents of your key employees. Consider purchasing life insurance policies on all owners and those key employees integral to the success of your business. Principal offers a key person calculator to help you and your financial professional determine the appropriate amount of coverage. ☐ Request a proposal		
Disability insurance		
Disability insurance protection - Consider protecting the value of your business, and your income if an owner or key employee becomes disabled. ☐ Request an illustration for individual disability income insurance ☐ Request an illustration for disability buy-out insurance ☐ Request an illustration for key person replacement insurance		

No one knows your business and your specific needs as well as you do. By working closely with your financial professional, you'll be able to formulate a plan that works for you. Whether it's analysis of your current plans, assistance with future plans, insurance protection or all three, Principal is here to help.

You benefit from a partner who knows business

As the owner of a business, your financial needs are different than those of other individuals. So, it only makes sense to work with a company that understands the financial needs of businesses and their owners. We help business owners like you every day. This means we have the expertise, solutions and services to consult with you on financial solutions that help address specific needs.

- No. 1 provider of nonqualified deferred compensation plans[1]
- Provider of nonqualified executive benefit plan administrative services for more than 4,700 employers, representing 75,000 plan participants.[2]
- Preparer of thousands of informal business valuations since 2011.
- Reviewer of more than 1,800 buy-sell agreements since 2011.

[1] Based on total number of Section 409A plans, PLANSPONSOR 2018 Record-Keeping Survey, June 2018.
[2] As of June 30, 2018.

Principal®

principal.com

The previous pages depict certain business planning options. All of these options are based on the information you shared with us for this purpose and the assumptions stated throughout the report. Of course, any variance in the information or assumptions could change the results.

All assets assume specific growth rates, calculated based on information from the client. These individual rates are used to project the possible growth of the business. These projections are made to estimate future business insurance needs.

Although the informal business valuation from The Principal can provide a valuable starting point in helping you determine the value of your business, the valuation will not be a substitute for a formal valuation nor does it establish a value for tax purposes. A formal valuation should be constructed with the guidance of your legal and/or tax advisors.

Solutions outlined in this report do not imply a recommendation that a specific business planning option should be implemented. Rather it represents a summary of potential considered strategies, which each individual should discuss with his or her tax advisor, attorney, and/or other professional advisor before taking any action.

Because your business planning goals may change in the future, periodic monitoring should be an essential component of your program.

All guarantees and benefits of the insurance policy are backed by the claims-paying ability of the issuing insurance company. They are not backed by the broker/dealer and/or insurance agency selling the policy, nor by any of their affiliates, and none of them makes any representations or guarantees regarding the claims-paying ability of the issuing insurance company.

Disability income insurance has certain limitations and exclusions. For costs and complete coverage details, contact your Principal representative.

Individual disability insurance Series 700. Not all products available in all states.

The subject matter in this communication is provided with the understanding that Principal® is not rendering legal, accounting, or tax advice. You should consult with appropriate counsel or other advisors on all matters pertaining to legal, tax, or accounting obligations and requirements.

Insurance products issued by Principal National Life Insurance Co. (except in NY) and Principal Life Insurance Co. Securities offered through Principal Securities, Inc., 800-247-1737, member SIPC. Principal National, Principal Life and Principal Securities are members of the Principal Financial Group®, Des Moines, IA 50392.

Customer confidential.

Not FDIC or NCUA insured
May lose value • Not a deposit • No bank or credit union guarantee Not insured by any Federal government agency

BB10880-05 (BB12499 Business Continuation Proposal Tool) I 02/2021 I 1511502-022021 I