Multi-owner buy-sell strategy

Prepare today for the future of your business.

For professional service firms

Presented to:

Sample firm

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Proprietary and confidential

We appreciate the opportunity to prepare and present this buy-sell strategy.

The information contained in this proposal has been developed based on our years of knowledge and experience in business succession planning. Rest assured that the information contained in this proposal will be kept strictly confidential.

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Planning now can help you later.

Do you and your co-owners have a strategy in place to transfer your business to the right people, at the right time, for the right amount of money? A multi-owner buy-sell agreement can help protect the future of your business.

This type of arrangement typically works well for multi-owner professional service firms that often have substantial liquidity needs. It gives the firm access to needed liquidity in the event of a death, disability, departure, or retirement of an owner. A comprehensive strategy can help you leave your firm on your terms while protecting you, the firm, and your family in the case of an unplanned event.

WHAT TO EXPECT

Let's look at how a buy-sell strategy can be tailored to fit your specific needs. You're in control of key decisions and determining next steps. This proposal will help you by covering the following areas:

Design. Look at the various agreement funding methods and choose the design that can help you accomplish your goals.

Financing. Decide which option best balances long- and short-term costs and benefits.

Support. Understand the valuable support services available to maintain this funding strategy.

Next steps. Review the process to implement your strategy.

Why is a buy-sell agreement important?

Before we dive into the details of designing your buy-out strategy, let's take a look at some important information about succession planning and the value of your firm.

Transitions are more successful when you have established a plan for your departure—whether expected or unexpected. You can protect your firm by putting a buy-sell agreement in place. This arranges for the purchase of a departing owner's interest. The agreement defines a clear price and sets purchase terms. The purchase can be triggered by death, disability, divorce, retirement, or other events.

It's not enough to just have a buy-sell agreement in place. It must be kept current and properly funded. This helps ensure owners will have the right amount of money, in the right place, at the right time.

Determining value

An important element of an effective buy-sell strategy is knowing the current value of your firm. If there's uncertainty about the company's value, this can result in an unintended negative financial impact to the owners.

Unfortunately, this step is often overlooked. This is why Principal® offers a complimentary informal business valuation service, using five generally accepted methods of valuation. If you would benefit from an informal valuation, let's discuss whether this may be an appropriate service for you.

If you have provided us with a valuation report for your company, that information is included at the end of this proposal, along with a summary of values by owner.

When set up properly, a buy-sell agreement can:

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

Buy-sell planning is critical to your retirement success.

As an owner, you might be thinking about using the sale of your firm to fund a large amount of your retirement. But developing a plan for both retirement income and a successful exit is one of the biggest financial challenges facing many owners today. It's important to get a fair purchase price for your business interest at retirement—and putting mandatory terms in place for the sale is key.

For firms like yours with more than one owner, being able to successfully sell your business interest at retirement can be dependent on the quality of the buy-sell agreement. A sale at retirement works best when the buy-sell agreement includes these important features:

- 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 insurance policies

You can avoid the impact of poor planning

Unfortunately, for many owners, retirement is not addressed in their buy-sell agreements. This can result in a negotiated sale, rather than a pre-planned sale under an existing and updated buy-sell agreement. The impact of a negotiated sale is intensified when there's a motivated seller ready to retire. In these instances, the impact to a motivated seller may be:

- Receiving less than fair market value
- Having to accept a smaller down payment
- Receiving payments over a longer term
- Accepting a lower interest rate on installment payments

Some professional firms have dissolved or been forced to restructure in part due to their inability to meet the liquidity needs triggered by departing owners. Owners who fail to plan may have unexpected disruptions in the cash flow of the firm and potential low morale due to concerns over the firm continuing.

The implementation of an effective buy-sell agreement is key for professional firms like yours.

Design your strategy

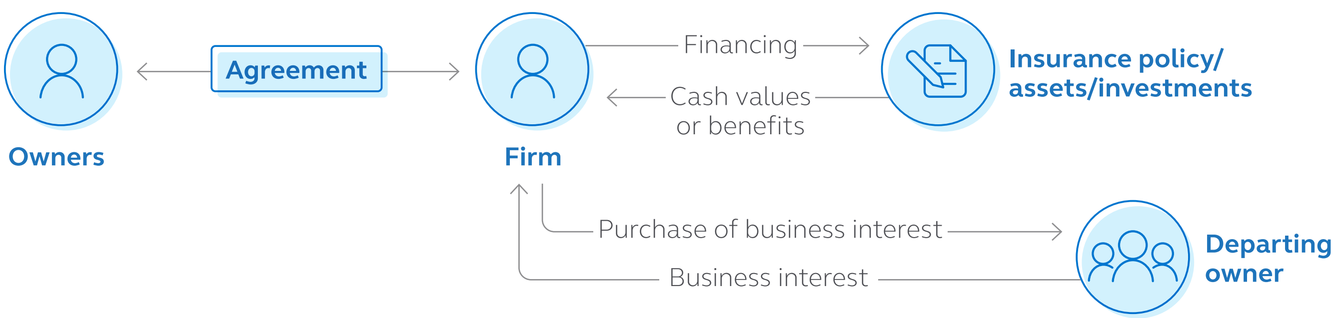
A multi-owner buy-sell agreement can be an effective succession strategy for professional firms with multiple owners who desire to exit the business at different times. Implementing this strategy could allow you to successfully transition out of the firm and secure your retirement.

You can potentially avoid the pitfalls of an unfunded or underfunded buy-sell agreement by establishing a funding program well before an exit occurs. The key is to carefully construct a plan that matches your cash flow needs and takes into consideration triggering events that happen both at death and during the owners' lifetimes.

Some considerations might include the cost of buying out the owners, the owners' ages, ownership interest, and expected departure dates. This buy-sell strategy helps provide the vital liquidity necessary for owners who are departing the firm, while protecting the viability of the firm for the remaining owners.

Here's how it works

Once an agreement is in place, the firm purchases a life and/or disability insurance policy on each owner to supplement other assets intended for buy-sell purposes. The firm is the owner, premium payer, and beneficiary of the policies. Upon a triggering event (death, disability, retirement, etc.), the firm purchases the departing owner's interest using available assets—may include the policy death benefit (if applicable) and policy cash values.



Benefits and considerations

Provides liquidity. Firms have dissolved or been forced to restructure, in part due to their inability to meet the liquidity needs triggered by a departing owner.

Incentive to stay with the firm. Owners can feel more confident about the future of the firm knowing there's adequate funding to buy out a departing owner's interest.

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 firm.

Tax implications can vary. Family members generally get a step-up in basis after the selling owner's death. For disability or other lifetime triggering events, the selling owner may recognize capital gain.

Planning for family-owned firms. If the departing owner's family members remain owners, special planning may be necessary.

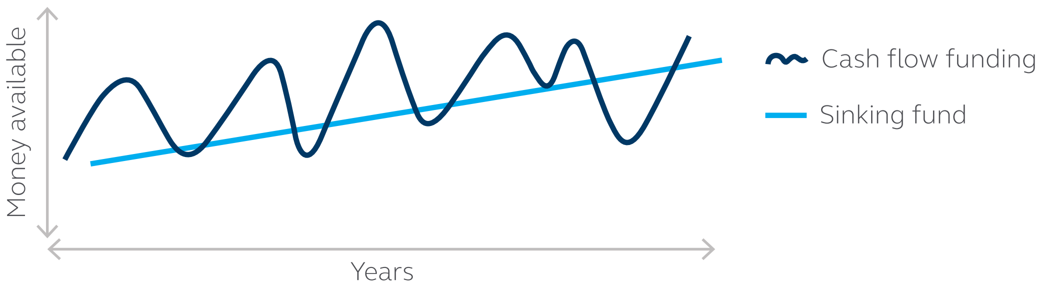
Possible impact on value of business. The U.S. Supreme Court in Connelly v. US (2024) held that if the buy-sell agreement does not successfully lock-in a value for estate tax purposes, life insurance paid to a company generally increases the value of the company for estate tax purposes, with no offset for the redemption obligation. If any owner anticipates being subject to the federal estate tax, the owners might wish to reconsider the buy-sell design. Alternatively, additional life insurance (likely owned in an irrevocable trust) may be needed to provide liquidity to pay any potential estate tax.

Helping to ensure proper funding for your agreement

Let's take a closer look at setting aside dollars today to meet cash needs in the future. There's value in creating a reserve in the event the costs for a given year exceed cash availability. The timing of owner retirements, terminations, deaths, and disabilities is unpredictable—and so is the amount of cash needed. A sinking fund can help.

What is a sinking fund?

A sinking fund is established when you systematically set aside money over time to fund future expenses, in this case, owner departures. The sinking fund provides a pool of money for making distributions when there are departures. Since cash flow can vary from month to month, a sinking fund may help the firm "level out" its cash commitments each year.



SINKING FUND **BENEFITS**

- Reduces and levelizes the cash flow required to purchase departing owners' interest in future years
- May be viewed positively by owners
- Helps finance owner buyouts and remains an asset on the company's balance sheet
- Is available for any corporate purpose

SINKING FUND **CONSIDERATIONS**

- Is not protected from creditor claims
- May be insufficient and the firm is ultimately responsible for fulfilling owner buyouts

Building a sinking fund

The decision about how much and what type of funding to use is a risk management decision. It's important to start early so assets have time to accumulate to meet your needs. There are several items for you to consider as you make your financing decisions.

Funding considerations

- Buy-sell triggering events
- Expected retirement dates for owners
- Buy-out terms
- Value of the firm
- Growth rate
- Ownership percentages of each owner
- Potential estate tax exposure of business owners
- Desired size of the reserve to be established
- Amount set aside by the firm to date
- Availability of cash on an annual basis
- Other benefit plans offered to key employees
- Cash flow needed to fund other current liabilities versus future buy-sell liabilities

Buy-sell agreements involve the selling and buying of departing owners' business interests according to the terms of the formal agreement. This means money will be needed to complete the transactions when they occur.

Having a plan to secure that money now will result in a better experience when the transitions occur. Any one—or a combination—of the three options below can be used.

Unfunded. No specific assets are set aside to fund buyouts. Instead, purchases are made using cash flow from the firm.

Investments. Contributions from the firm are invested in vehicles such as stocks, bonds, CDs, or mutual funds.

Insurance. The firm purchases insurance to pay future obligations. The firm is the owner and beneficiary of the policies.

- **Life insurance.** Contributions are paid into cash-value life insurance policies—either fixed, indexed, or variable. Then, in the event of an owner's death, any death benefit would be paid to the firm.
- **Disability insurance.** Contributions are made into disability buy-out insurance policies. Then, should an owner become totally disabled, insurance proceeds can be used to buy out that disabled owner's shares.

Benefits and considerations

	Unfunded	Investments	Insurance
Benefits	• Simple • No assets to manage	• Direct crediting of earnings • Flexible contributions • No medical underwriting • Investments reported on the balance sheet of the firm • Investments available for any business purpose	• Immediate availability of benefit in the event of an owner's death • Life and disability insurance[1] policies may selectively cover majority owners • Flexible life insurance contributions • Life insurance earnings accumulate tax-deferred • Life insurance cash surrender values are an asset on the balance sheet of the firm and may be available for any business purpose • Life insurance income tax-free death benefits may provide cost recovery • Disability buy-out benefits are received income tax-free
Considerations	• No future assets set aside to pay benefits • Liquidity risk • Stock redemptions can be volatile • Cash may not be available, potentially requiring debt and other financing	• Earnings may be taxable • Investment fees and expenses • No death benefit	• Must qualify for and meet underwriting guidelines for life and disability insurance • Cost of life and disability insurance, policy fees, and expenses • Life and disability insurance premiums are not tax deductible • Owners insured by life insurance must sign a Notice and Consent form (IRC Section 101(j))[2] • Risk that death benefits might inflate value of business[3]

Accumulation may take time, and timing of need can be unpredictable.

To help you better weigh your options, review the detailed financial model included with this proposal.

(1) For Principal disability buy-out insurance, business owners with at least 5%, but less than 10% ownership interest in the business are eligible if there are at least four active owners and no one owner has more than 80% ownership interest; otherwise,10% ownership is required.

(2) The overall framework of IRC Section 101(j) imposes certain requirements, which if met, will generally allow death benefits of employer-owned life insurance to be received income tax free.

(3) Connelly v. US, No. 23-146, 602 U.S. ___ (June 6, 2024)

Help protect your buy-sell strategy with insurance

Firms with two or more owners can benefit from fully funding your buy-sell agreement with life and disability insurance to protect you, your business, and your family against unplanned events. But, for professional service firms like yours, because of the size and number of owners, it's just as important to fund for planned events, such as terminations and retirements.

Consider choosing a funding vehicle that will match your need for funding as each planned and unplanned event occurs. For example, cash value life insurance can provide a source for lifetime buyouts—such as retiring or terminating owners. In addition, you can plan for the premium payments over the long term and include them in your budget. This will help prepare you for all planned owner departures.

If an owner should die or become disabled, life and disability insurance can also help provide needed liquidity and protect cash flow from being used for funding the purchase and sale of that departing owner's shares. So, it's important to make sure your buy-sell agreement is properly funded with the type of life and disability buy-out insurance to address all your owner departures. This is something that's often overlooked, creating a higher likelihood that a planned sale may not occur as intended.

Your insurance options

As you think about protecting your buy-sell agreement, keep these things in mind.

Term life insurance. Historically a popular choice for funding buy-sell agreements. But, coverage is only for a set number of years and does not accumulate cash value.

Permanent cash value life insurance. Accumulates cash value over time and covers the insured's lifetime. This may be a better funding solution for your buy-sell agreement because it can be used to:

› Fund the buy-sell agreement to protect in multiple scenarios

› Establish a sinking fund

› Provide the firm with access to funds that may be needed for a down payment to buy out a transitioning owner's interest

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Disability buy-out insurance. Does not accumulate cash value, but provides funding for remaining owners to buy out a disabled owner's interest, as detailed in the buy-sell agreement.

Focused on your strategy details—today and tomorrow

It takes a lot of work to run your business. We understand you may not have time to think about the details associated with administering your buy-sell funding strategy. That's why we're here. We offer the expertise and service to help you with implementation and administration.

Expertise

When implementing a new strategy, it's helpful to work with a provider that has the expertise and experience to understand how to turn your objectives into a successful strategy. Our team of business solutions professionals will consult with you and your financial professional to determine the right solution for your business.

Service

We know you need to spend your time focusing on your business. That's why we focus on the details so you don't have to. Our plan administrative service professionals assist you with the day-to-day aspects of your strategy.

Walking you through a successful implementation

Helping you tailor an effective buy-sell strategy to meet your specific needs and goals is a top priority. Once you are comfortable with the design of your strategy and the supporting funding, attention will shift to putting the strategy in place using the Principal platform.

As everyone works together to successfully implement your funding strategy, our goal is to deliver a positive experience. Here's what you can expect:

Next steps

1 Strategy development

- Discuss design options
- Offer sample buy-sell documents for local attorney
- Confirm funding levels

2 Application process

- Educate owners on the funding program
- Collect applications and signatures, if applicable

3 Administrative set-up

- Finalize underwriting, if applicable
- Enter plan information into recordkeeping systems

4 Implementation

- Begin premium payments
- Issue insurance policies, if applicable

You benefit from a company that knows business.

As a business decision maker, 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. Leverage our expertise, solutions, and services as we consult with you on financial solutions that help address specific needs.

- A member of the FORTUNE 500®, we have $695 billion in total assets under management and serve clients worldwide of all income and portfolio sizes.[(1)]
- Year after year, we receive competitive financial ratings from the four major rating agencies — A.M. Best Company, Moody's Investor Services, Standard & Poor's, and Fitch Ratings.[(2)]
- No. 1 provider of nonqualified deferred compensation plans.[(1)]
- Preparer of thousands of informal business valuations since 2011.
- Reviewer of more than 2,600 buy-sell agreements since 2011.

(1) Principal® 2024 Company Profile, December 2023 https://secure02.principal.com/publicvsupply/GetFile?fm=DD730&ty=VOP&EXT=.VOP.

(2) Third party ratings relate to Principal Life Insurance Company and Principal National Life Insurance Company only, and do not reflect any ratings actions or notices relating to the US life insurance sector generally. Ratings current as of xx/xx. Ratings are not a recommendation to buy, sell or hold a security. Ratings are subject to revision or withdrawal at any time by the assigning agency, and each rating should be evaluated independently of any other rating. Information is current as of the creation of this piece. Keep in mind that portfolio holdings are subject to risk.

Tax considerations

Payments for the purchase of business interests are generally taxed favorably.

- Tax-free return of cost basis
- Capital gains subject to a 15 or 20 percent capital gains tax rate
- Ordinary income for the interest portion of the payment

Income tax	Impact
For the business	• Life and disability insurance premiums not tax deductible • Life and disability insurance benefits received income tax-free
For the purchasing owner	• **For C corporations.** No basis increase to surviving owners • **For S corporations and other pass-through entities.** With planning, surviving owners may be able to obtain some basis increase
For the seller upon death	Purchase price received generally doesn't cause taxable event[1]
For the seller upon a lifetime triggering event (disability, retirement, etc.)	Seller recognizes capital gain to the extent proceeds exceed basis

Estate tax	Impact
For the seller upon death	Value of business interest included in gross estate

[1] If purchase price received is equal to value of business interest at death, there will generally be no income tax payable upon sale.

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