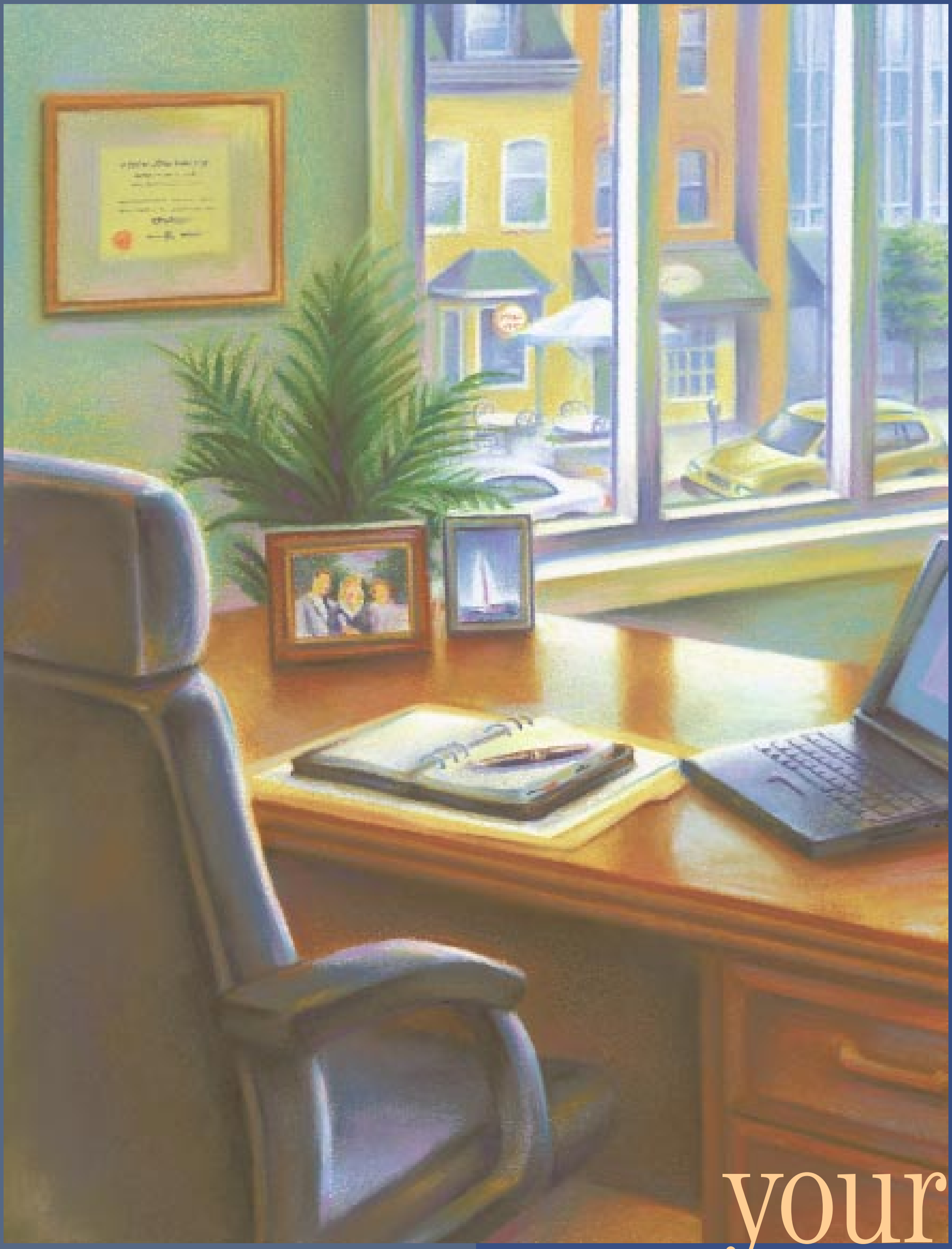
BUSINESS SUCCESSION



your guide

Freedom 55 Financial

A division of London Life Insurance Company

Yesterday a dream

Today a thriving business

Tomorrow a legacy

Your business succession guide

Many small business owners don't have a business succession plan in place leaving them unprepared for retirement, disability or death.

This guide will help you understand the need for a business succession plan. We've included information on issues you'll need to consider to start you on the right track such as:

- a checklist to help you identify your needs
- establishing a buy-sell agreement
- determining the value of your business
- protecting yourself from the loss of key employees

Whether you look to your business to provide you with a retirement income, dream of one day passing the business on to your child, or plan on selling it to a third party, this guide will help you work with your Freedom 55 Financial security advisor to develop the right plan to suit your specific needs.

Should you have a business succession plan?

If you own a business, the answer is yes. When you're building and running a business, thoughts of selling it or passing it on to others are often far from your mind. However, that day will eventually arrive and, as in all business matters, the earlier you plan the more successful the transfer will be.

Business succession planning is really an extension of your personal estate planning but with a focus on the future operations of your business.

Planning for retirement, planning for your heirs and employees upon your death, and planning for the person who takes over the reins of your business are closely tied together. However, your planning objectives in each of these situations may be different.

What is a business succession plan?

A business succession plan determines how your business will be transferred to others and outlines the steps necessary to prepare for the transition.

The plan affects you, your family, employees, clients, suppliers, creditors and others. A good succession plan ensures that your wishes will be carried out if you should die suddenly or can no longer run your business due to illness or disabling injury. It can also help you ease into retirement or provide a retirement income.

Six key steps

Every business and personal planning situation is different. Every succession plan is also different. Taking the time to think through these six key steps will help you start your business succession plan. Your financial security advisor can work through these steps with you and provide you with more specific information when necessary.

1. **Assess your current situation**

   Determine the potential profitability of your business if you were no longer there to run it and consider the steps that would be required to maintain profitability.

2. **Understand your goals for your business and your family**

   Consider what business succession plan will be best for you and your family. Is your goal to have a family member continue to own and manage your business or perhaps own the business with outside management assistance? You might wish to sell your business to key employees or a third party. Or, it may suit you better to sell parts of the business or liquidate the business assets.

3. **Identify and prioritize action plans**

   Work with your professional advisors to determine what must be done in order for your business succession plan to proceed and succeed.

4. **Select the best action plan**

   With help from your financial security advisor and from the various alternatives considered, select the plan that best meets your established objectives.

5. **Document your decisions**

   Put your business succession plan in writing and forward it to your professional advisors to review, adjust and file for safekeeping.

6. **Implement your plan**

   Many parts of your plan will likely not need to be implemented for many years. However, some items may require immediate attention – insurance coverage to fund a buy-sell agreement, training of a child successor in key business areas and introducing the successors to key suppliers and contacts, and/or updating wills and buy-sell agreements.

Planning for unforeseen events

It is just not practical to undertake a succession plan for your business without considering the possibility of a disability or your early demise, either while you still own the business or when you are retired but still involved to some degree. Thinking about succession planning requires asking some tough questions.

- When I die, how will I divide my estate amongst my family in a way that is fair and equitable to all?
- Who will take over control of my business?
- What other assets do I have and who will receive them?
- How much control over the business do I want to retain when I retire?
- When will I release control completely?
- Where will the money come from to fund the purchase of my business and fund my retirement?
- How will my family retain their standard of living when I die or if I become disabled?
- How will I ensure my business continues to run smoothly?

Changes in life stages such as marriage, death, or divorce can all impact the business succession plan you create. Review your plan regularly and amend it for any changes in your situation or goals over time.

Getting started

Take the time to go through the following checklist.

Will

- ☐ Have you made out a will?
- ☐ Do you need to revise your will?
- ☐ Has your personal situation changed?
- ☐ Have you had children since it was last revised?
- ☐ Have you married or become separated or divorced?
- ☐ Have any of your children married?

Family

- ☐ Are new family members or other individuals becoming increasingly involved in the business?
- ☐ Has your spouse taken on a more active role?
- ☐ Have your children become involved?
- ☐ Do you have a successor manager in place should you suddenly die or become disabled?
- ☐ If one child receives ownership in the business, what assets will your other children receive?
- ☐ Do you have other assets worth sufficient value to do this?
- ☐ How will your spouse be looked after once your child takes over the business?
- ☐ Will having your child take control of the business impact the business profitability?

Make sure you consider every point. Each consideration is important in helping your advisors properly structure a business succession plan that meets your goals for both your family and your business. Your financial security advisor can help.

Business

☐ Has your business structure changed since you last reviewed your will?

☐ Is your business more or less profitable than when you last reviewed your will?

☐ Have new partners or shareholders come onboard?

☐ What are the future prospects for your business?

☐ Will internal or external events affect future profitability?

☐ Do you plan any expansion?

☐ Are there major obstacles or threats on the horizon?

☐ Will you receive a retirement income from the business?

☐ Will you sell the company when you retire?

☐ Will you sell it to a family member or to a third party?

☐ Do you plan to stay actively involved in your business when you retire?

☐ Do you want to maintain ownership to provide income during retirement but not stay actively involved?

Insurance planning

☐ Have you recently reviewed your insurance program with your financial security advisor?

☐ Are you prepared in the event of premature death?

☐ Disability?

☐ Critical illness?

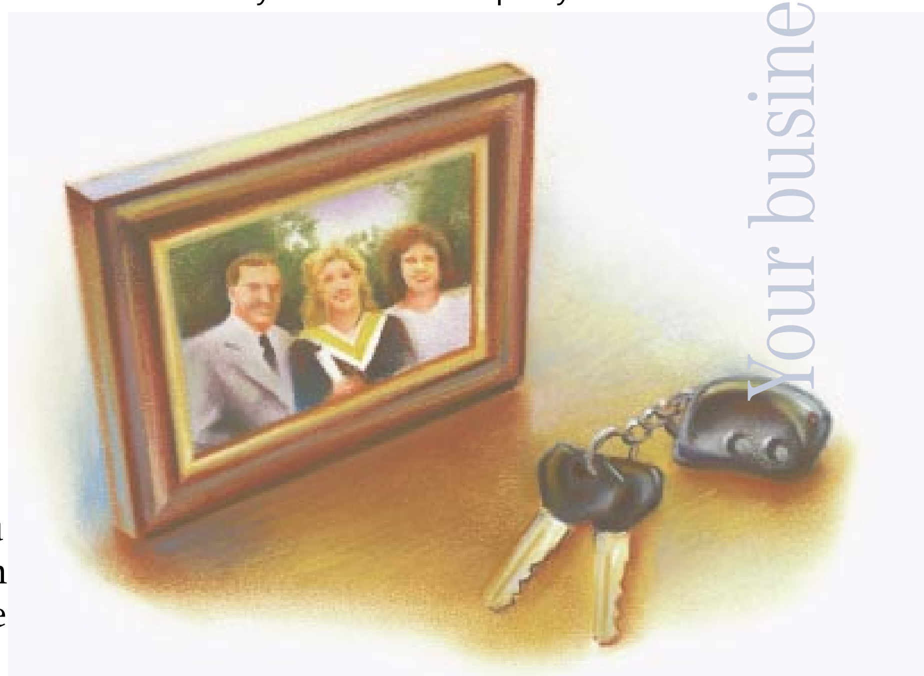
☐ Has the value of your business changed significantly since you put your plans in place?

☐ Has your successor owner changed since the above plans were created?

Tax planning

☐ Does your business qualify for the Enhanced Capital Gains Exemption?

☐ If not, are there any adjustments you can make to your business to qualify?



Once you've answered these questions, discuss your responses with your Freedom 55 Financial security advisor and together you can develop a business succession plan that will help you secure the ongoing success of your business into the future.

Change of ownership

It could have been a long-held dream come true or years of learning the ropes, but now you own your own business. Today, you are more committed than ever to contribute your time, energy and expertise to continue to make your business a success.

Without your efforts and expertise there is probably a good chance that your business would seriously suffer.

There's no way to guarantee your good health. However, you can take steps to prevent a death or disability from harming or even destroying your business by setting up a properly funded buy-sell agreement.

A business succession plan determines how your business will be transferred to others and outlines the steps necessary to prepare for the transition.

Buy-sell agreement

A buy-sell agreement is a plan that provides for an orderly change of ownership under certain circumstances; for example, when a business principal dies or becomes disabled. It's designed to establish a value for the business, now *and* in the future. A buy-sell agreement sets out the terms under which the interest of the disabled or deceased shareholder will be sold. It also contains provisions for the transfer of ownership when you retire. As well, if properly funded, the shareholder's family will receive fair market value for the shares, providing them with capital to help maintain their standard of living.

A properly funded buy-sell agreement can:

- assure creditors that funds will be available to pay their bills (some lenders may stipulate that a buy-sell agreement be in place before extending credit).
- assure existing employees that the company will have the means to continue.
- ensure a market for each shareholder's interest in the business.
- set the terms under which you and your fellow shareholders agree to buy and sell each others' interest in the business.
- provide for your family in time of need.

The most cost-effective method to fund a buy-sell agreement, in the case of the death of a shareholder, is through life insurance. This approach helps to ensure that the required amount of capital will be available should it become necessary to buy out an interest in your business.

Advantages of a funded buy-sell agreement to the deceased's estate

- Ensure a market for the shares and guarantees a buyer for the shares of the business
- Provide the heirs with a predetermined price for the shares

Advantages of a funded buy-sell agreement to the surviving shareholders

- Protect them from unwanted shareholders such as family members of the deceased
- Allocate the shares in a manner agreeable to all shareholders
- Establish the method to determine the price of the shares

Determine the value of your business

While it's ultimately your and your accountant's responsibility to arrive at a value today to facilitate funding decisions, it's important to understand some of the principles involved in the valuation process. There are a number of methods you and your accountant can use to determine a purchase price for a buy-sell agreement. The valuation clauses of the buy-sell agreement should give clear direction on the date the value is to be established. Below are advantages and disadvantages of three commonly used methods.

Fixed value method

The actual purchase price is specified in the buy-sell agreement and should be re-determined annually with the agreement updated accordingly.

Advantages

- Simplicity and certainty
- Shareholders can easily determine the price to be paid for their interests and plan accordingly

Disadvantage

- Value must be re-determined each year and the agreement updated

Formula method

The purchase price is determined at the time of death by a formula stated in the buy-sell agreement. Some of the more common formulae used calculate the book value or adjusted book value of the business. Other formulae might base the value of the business on a multiple of earnings or a multiple of sales.

Advantages

- No need for an annual review
- Inexpensive to determine the purchase price using the formula method

Disadvantages

- The terms, *book value* and *adjusted book value* have no generally accepted definitions and could lead to potential disagreements, even if the terms are defined in the agreement
- Once set, these formulae don't change to reflect changing business or economic conditions
- Not very useful where the formula cannot take into account the increasing values of property owned by the company or the value of goodwill

Fair market value method

The purchase price is based on a fair market valuation of the business at the time of death. The agreement may call for a valuation to be performed by a specified licensed valuator or some other party such as the company's accountant. It's preferable to have a third party value the business to receive an objective value. As an alternative, the parties to the agreement may negotiate a price with arbitration procedures set out in the case of disagreement. The agreement should clearly exclude life insurance death proceeds from this calculation.

Advantages

- Ensures the shareholders and family receive fair market value for their shares at the time the buyout is exercised
- Should result in a fair solution for all parties

Disadvantages

- May be costly and there will be no definite value available for funding arrangements unless a valuation is completed today
- As market conditions change, the fair market value can fluctuate significantly

Shotgun clause

An approach often used in buy-sell agreements is a shotgun clause. This clause applies when there is dissension among partners or shareholders, or a desire to sell. With this option, shareholders that want to sell shares offer them to other shareholders at a specific price. The other shareholders then have the option to purchase the shares at that price. Or, should they choose, they can sell their shares to the shareholder that made the initial offer to sell, according to the same terms and conditions as that initial offer.

If the initial seller asks too high a price for the shares, the purchasers would decline the offer and demand the sale of their shares to the seller at that high price, or if the initial seller specifies a low price, they would be cheating themselves of a fair price. A shotgun clause should result in a fair price for the purchase and sale of the shares.

Protection for the future

Establishing a properly funded buy-sell agreement between shareholders, or for a successor owner, provides security and the knowledge that your business can continue to prosper even in the event of tragedy.

Buy-sell agreements are complex and unique to your particular situation. Therefore, you should consult the appropriate legal, accounting or tax experts for assistance in drafting a buy-sell agreement that meets the needs of your situation. Your Freedom 55 Financial security advisor can work with you and your other advisors to help determine a suitable buy-sell agreement and help ensure the appropriate insurance plans are in place to fund the agreement.

Protect your business from the loss of a key person

Your office equipment and inventory are valuable assets, but are they as valuable as your key employees? Consider a top salesperson who is unsurpassed at bringing in revenue or new accounts, or a researcher whose innovative ideas have helped the company flourish.

Key employees may be your most valuable resource. Their energy, expertise and dedication can give you an edge over your competition and enable your business to succeed. What would happen if one of your key employees died or became disabled?

Profits could be affected and you might be forced to absorb the high costs associated with recruiting, hiring and training a suitable replacement.

You can't guarantee the continued good health of your employees, but insurance on the lives of your company's key people can help prevent an unexpected loss from financially harming or even destroying the business that you have built with the help of these valuable employees.

Key person insurance provides security and the knowledge that your business's bottom line won't suffer even if you or one of your key employees dies or becomes disabled. It is simply good business.

Key people

Key person insurance provides life insurance or disability benefits to your company if it suffers the loss of a key employee. A key person is anyone associated with your business whose unique talents make a significant contribution to your bottom line, such as employees with:

- special technical skills
- strong relationships with valued customers
- skills in attracting new business
- responsibility for major projects

As the owner, you and other shareholders of the business may also be key to the operation of the business.

Key benefits

Key person insurance can help protect your business in many ways.

- Provides tax-free funds at the exact time they're needed
- Helps keep the business running
- Provides funds to help attract, hire and train new employees
- Compensates the business for lost revenues resulting from the death or disability of the key person
- Assures creditors that funds will be available to meet commitments
- Assures existing employees and your customers that the company will have the means to continue

Determine the value of your key person

Take a few minutes to go over this checklist. It will help you identify the value of your key person and how this loss could impact your business.

Will the loss of your key person impact the company financially?

Your Freedom 55 Financial security advisor can work with your other advisors to help determine the impact of the loss of a key employee and implement key person insurance as part of your business succession plan.

- ☐ **Will it affect profits?**
  - For how long?
- ☐ **Will there be a cost to replace this person?**
  - Recruiting
  - Education
  - Training
  - Relocation
- ☐ **Could this loss impact your company's credit?**
  - Will creditors shorten payment terms?
  - Will creditors call loans?
- ☐ **Will you lose key clients?**
- ☐ **Is your company at risk of losing employees?**

Your unique plan

Business succession planning involves a variety of business and personal issues which need to be considered together. Every plan is unique therefore, it's important to develop your business succession plan in consultation with your legal, accounting and tax professionals.

Your Freedom 55 Financial security advisor can work with your other advisors to help you create a plan that meets the goals and dreams for both your business and your personal life.

You've invested in your business and nurtured it. Now take the appropriate steps to ensure that it continues to prosper and to provide your family with a source of livelihood for years to come.

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The information in this brochure is not intended to serve as legal, accounting, or tax advice. You're encouraged to consult with your professional advisors for advice concerning specific matters before making a decision. Your financial security advisor can work with your other advisors to help determine the optimum value for your business and the most appropriate funding vehicle to help fund the sale.

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