



# UNDERSTANDING BUY-SELL AGREEMENTS

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As a business partner or co-owner, you've likely spent numerous years building a successful organization as well as a valued financial interest in the company. Sometimes life throws us curveballs and it's important to ask yourself the following questions:

- What would happen to my business if I passed away?
- Weren't able to work anymore?
- Wanted to walk away from the business?

Establishing a buy-sell agreement allows there to be a clear and concise plan in place for your business in the event something unexpected occurred. Buy-sell agreements allow the business to continue to run seamlessly without any drastic effects.

## WHAT IS A BUY-SELL AGREEMENT?

A buy-sell agreement is a legally binding agreement between the co-owners of a business that governs the situation should something happen to one of the owners. It is also known as a "business will" or a "buyout agreement". They can take different forms such as:

### Cross purchase plan

- Each owner purchases a life insurance policy on the other owner(s). Each pays the annual premiums on the policy they own and is the beneficiary of the policy.
- If an owner dies, the surviving owners use the death benefit to purchase the deceased owner's share of the business.
- Multiple policies must be purchased by each owner if there are many owners.

### Entity redemption plan

- Each owner has an agreement with the business for the sale of their respective interests.
- The business purchases separate life insurance policies on every owner, pays the premiums, and is the owner and beneficiary of the policy.
- If an owner dies, their share of the company stock will pass on to their heirs or estate, where the company may purchase them with the proceeds from the life insurance policy.
- May also be called a "stock redemption plan" for corporations.

### Hybrid plan

- This plan combines both the cross purchase and entity redemption plan.
- The owner is required to offer their interest to the entity. If the entity declines or cannot make the purchase, the co-owners may purchase the shares.
- Certain employees may be given the opportunity to purchase the interest at this time.

### One way buy-sell plan

- This plan is often used when a sole owner wants a child, spouse or a key employee to purchase the business if the owner dies or becomes disabled.
- This individual would buy an insurance policy on the owner and be the beneficiary. Premiums may be paid by he/she or the company.

## IMPORTANT THINGS TO CONSIDER WHEN ENTERING A BUY-SELL AGREEMENT

### Develop the agreement early

- Create the agreement well before it is needed.
- Developing an agreement early will make it less emotional in big decisions.
- The focus will be on making an agreement rather than the owners' own interests.

### Establish triggering events

- Discuss the events that would cause the agreement to go into effect.
- Some of the triggering events could include death, disability, divorce, bankruptcy, retirement, etc.

### Establish ground rules

- The agreement should outline who can or can't be a buyer and how the business will be funded.
- Outlining how any sale of ownership is to be funded helps ensure proper planning of company liabilities.

### Be aware of tax implications

- There are certain ways to structure a company sale or buyback to minimize taxes.
- Being tax savvy could prevent owners from receiving drastically reduced proceeds if they're planning to fund their retirement by selling shares.

### Identify the value of the business

- Establishing a fair price for the business is essential in determining the owners' shares of the business.
- Determine what items will be considered in the business valuation.
- Allows owners to have control over how the value is determined.

## BUSINESS VALUATION METHODS

- **Fixed price** - Owners determine a predetermined price per unit that would be paid to the departing partner should a triggered event occur.
- **Formula based** - The purchase price is determined via a mathematical formula that could be based on book value, cash flow, seller discretionary earnings, etc.
- **Valuation based** - A professional third party provides a business appraisal at the time of the triggered event. This could be a single appraiser or multiple appraisers.



### Pros

### Cons

	Pros	Cons
<b>Fixed Price</b>	<ul style="list-style-type: none"> <li>- Less expensive</li> <li>- Less time-consuming</li> <li>- Easy to communicate</li> <li>- Easy to understand</li> <li>- Certainty of value</li> </ul>	<ul style="list-style-type: none"> <li>- May not reflect accurate value at the time the price is set</li> <li>- Can overvalue or undervalue</li> <li>- May not reflect current market conditions</li> <li>- Difficult to negotiate a set price</li> </ul>
<b>Formula Based</b>	<ul style="list-style-type: none"> <li>- Less expensive</li> <li>- Less time-consuming</li> <li>- Easy to understand</li> <li>- Provides some flexibility in capturing changes within the business</li> </ul>	<ul style="list-style-type: none"> <li>- May not reflect accurate value at the time the price is set</li> <li>- May not reflect current market conditions</li> <li>- Requires a rigid definition of formula</li> <li>- No flexibility for adjustments</li> <li>- Less certainty of value and result than a fixed price</li> </ul>
<b>Valuation Based</b>	<ul style="list-style-type: none"> <li>- Most accurate at determining current value of business</li> <li>- Provides flexibility</li> <li>- More in depth analysis</li> <li>- Third party perspective</li> </ul>	<ul style="list-style-type: none"> <li>- More expensive</li> <li>- More time-consuming</li> <li>- More difficult to understand</li> </ul>
<b>Single Appraiser</b>	<ul style="list-style-type: none"> <li>- Parties agree on appraiser during non-confrontational time</li> <li>- Agreement on process and approach</li> <li>- More certainty in process</li> <li>- Less expensive</li> <li>- Less time-consuming</li> <li>- Less distracting to mgmt.</li> </ul>	<ul style="list-style-type: none"> <li>- Difficult to agree on one single appraiser</li> <li>- Less variability on key assumptions</li> <li>- If not regularly updated, can be uncertainty with final price</li> </ul>
<b>Multiple Appraisers</b>	<ul style="list-style-type: none"> <li>- By selecting their own appraisers, parties gain confidence in process</li> <li>- Allows variety of views on key assumptions</li> </ul>	<ul style="list-style-type: none"> <li>- More expensive</li> <li>- More time-consuming</li> <li>- Uncertainty on process and final price</li> <li>- Increased risk of conflict</li> </ul>

**PLEASE LIST THE NAMES OF 5 CLIENTS THAT COULD BENEFIT FROM THIS PROGRAM:**

Name

Phone #

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| 1) _____ | _____ |
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