



## **Business Owner Retirement**

# **How ready are you for retirement?**

## **Your personalized Business Owner Retirement Analysis**

**Presented to:**

**Valued Client**

**Presented by:**

**Producer Name**

# What will it take to retire?

We can see that you've worked really hard to build a successful business. Now, it's time to take a few steps to make sure you're building a solid foundation for the retirement you've been dreaming about. Your business can play a key role in this planning. Depending on the value of your business and the strength of your transition plan, your business can generate income during retirement, just like it has done through your working years. All it takes is some careful planning.



**Reviewing this personalized report is an important next step.**

**Your Business Owner Retirement Analysis from Principal<sup>®</sup> will walk you through what you need to consider in building your plan for retirement security. We will examine these key areas:**



**The value of your business - Has your business been valued recently?**



**Your business transition plan - Have you determined when and to whom you will transition your business? And, do you have an effective plan in place to make that happen?**



**Your retirement income goal - Will your current assets, including your business and any retirement plans, generate the income you need?**



**The protection of your retirement - Are your plans protected from unexpected events that could potentially derail your retirement security?**

**This report was created specifically for you and will analyze the plans you have in place and their ability to meet your retirement income needs. If any gaps are identified, we will recommend solutions to help you get on track for a secure retirement.**

## Informal business valuation

It's important to know the current value of your business in order to know how much it can contribute to your retirement income goal.

Now, there are many different methods for determining value and no one method is always appropriate. Ultimately, the "fair market value" of a business is the amount agreed upon by a willing buyer and a willing seller.

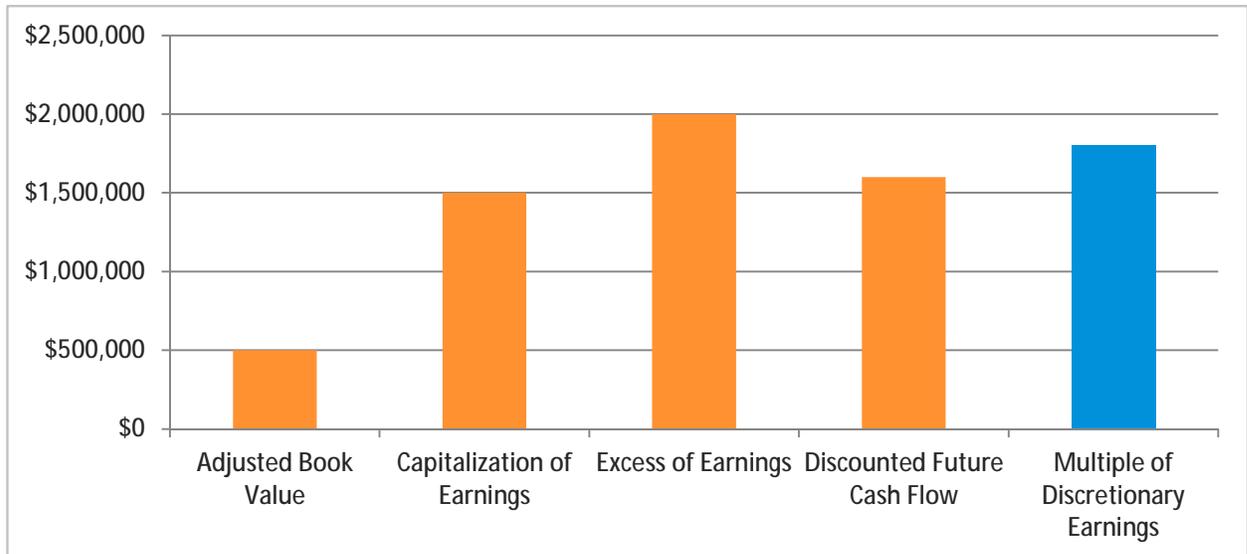


**Here are some considerations when valuing a business:**

- **Nature and history of business**
- **Outlook for 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**

## The informal valuation of your business

Based on the details you provided, the following are estimated informal valuations for your business using five generally accepted methods of valuation. Your company profile suggests the highlighted value below may be most appropriate for your business.



<b>Adjusted Book Value Method</b> Assets, with adjustments, less liabilities - generally represents the "liquidation" value	\$500,000
<b>Capitalization of Earnings Method</b> Amount of capital that would have to be invested at a specified rate to yield the current average net earnings of the business	\$1,500,000
<b>Excess of Earnings Method</b> A combination of the Adjusted Book Value and Capitalization of Earnings methods	\$2,000,000
<b>Discounted Future Cash Flow Method</b> Projected future business earnings forecasted, then discounted using an appropriate rate	\$1,600,000
<b>Multiple of Discretionary Earnings</b> Earnings provided by goodwill, times a multiplier, adjusted book value is added to this number	\$1,800,000
<b>Highlighted Value</b>	<b>\$1,800,000</b>

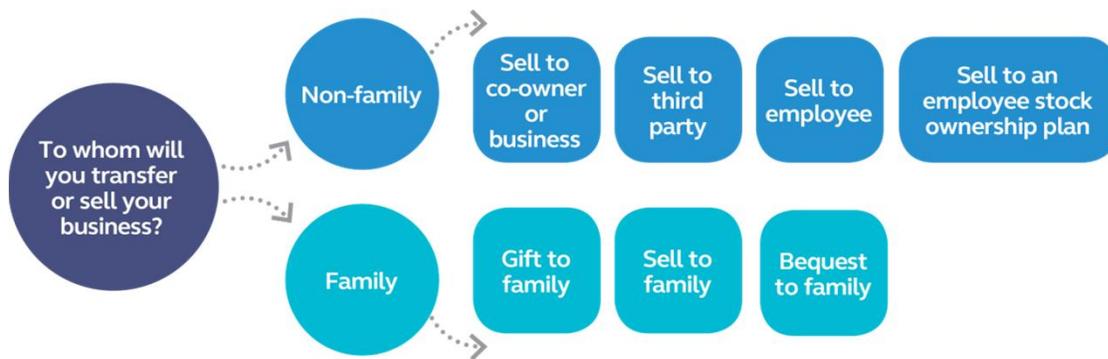
Note: Please refer to the full Informal Business Valuation report for additional information on how this valuation was determined.

# Business transition plan

If you're like many business owners, you're planning on your business playing a key role in providing your retirement income. Perhaps you're thinking about selling it and taking a lump sum or regular installment payments. Or, maybe you intend to gift the business to a family member.

In order to protect yourself, your family and your business, it's important to determine exactly to whom, how and when you want to transition your business. Identifying the buyer and determining a purchase price is critical for retirement planning as well as protecting your family in the event of an unplanned exit from the business.

First, ask yourself *who* and *how*.



Then ask *when*. Make sure you consider both planned and unplanned exits from your business – such as retirement, dissolution, death, disability, divorce and termination.

Based on the information you provided, we understand this is your business transfer goal:

- You intend to transfer your business in 10 years to a key employee using an installment note.

## A buy-sell agreement lends protection

After identifying your business transition goals, documenting these decisions in a buy-sell agreement can protect your long-term financial well-being. A well-funded buy-sell agreement is an essential planning tool to help enhance the stability, manage known transitions and protect the financial value of your closely held business from unplanned events.

Principal can help you design a properly funded buy-sell agreement which:

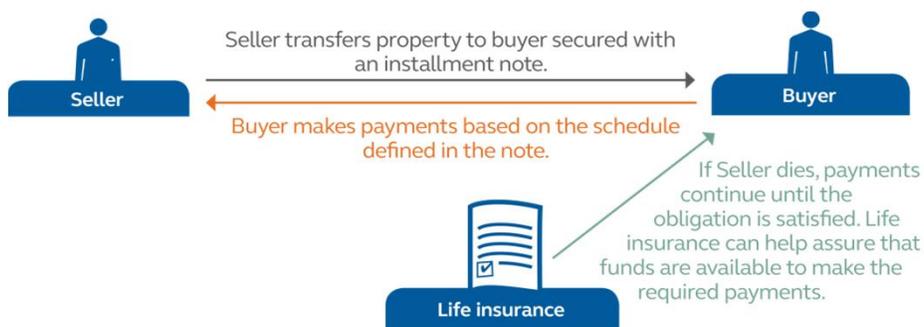
- Provides departing owners a market and price for an asset that might be hard to sell.
- Prevents an unqualified/undesirable individual from acquiring an interest in your business.
- Minimizes business disruptions at trigger events (e.g., death, divorce or retirement).
- Offers assurances to employees, customers, suppliers and creditors that the business will remain strong through owner transitions.
- When funded with insurance, provides both the financing and the mechanism to ensure that control of the business will remain with the current owners.

## Transition solution: installment sale

Based on our understanding of your business transition goals, a strategy that may be effective for you is an installment sale. With this type of sale, the seller receives one or more payments after the close of the tax year in which the sale occurs.

How is the amount of payment determined? It's a calculation that uses:

- The value of the business at the time of transfer
- An interest rate equal to or greater than the long-term applicable federal rate (AFR) in effect during the three months prior to the writing of the contract



This strategy allows you to convert the business into a retirement income stream, and spread the gain and any resulting taxes on the sale over time. The buyer also does not need to have all of the funds to purchase the business in a single payment.

### Benefits

- Payments can be tailored to match the exiting owner's business and financial needs.
- A specific payout period is defined.
- A market is created for the business where none previously existed.
- Business interest and appreciation are immediately outside of the exiting owner's estate.

### Considerations

- By accepting an installment note, there is a risk the buyer will default on the loan.
- The seller will likely want to require an initial down payment.
- After-tax dollars will be used to fund the purchase.
- The buyer needs a down payment. If the buyer is an employee, a supplemental retirement plan may help with funding.
- Payments must be made for a specified period of time, even if the exiting owner dies.
- Life insurance can help assure that funds are available to make the required payments.
- The present value of any remaining installment payments is included in the exiting owner's estate.

## Transition solution (continued)

Below is a proposed schedule of payments.

Installment Note				Cost to Buyer		Net to Seller			
Year	Beginning-of-year note value	Interest & principal payment	End-of-year note value	Pre-tax annual cost	After-tax annual cost	Annual proceeds	Personal income taxes	Capital gains taxes	Net proceeds to seller
0	2,500,000	250,000	2,250,000	384,615	250,000	250,000	-	40,000	210,000
1	2,250,000	291,385	2,071,115	448,285	291,385	291,385	39,375	28,622	223,389
2	2,071,115	291,385	1,883,285	448,285	291,385	291,385	36,245	30,053	225,088
3	1,883,285	291,385	1,686,064	448,285	291,385	291,385	32,957	31,555	226,872
4	1,686,064	291,385	1,478,982	448,285	291,385	291,385	29,506	33,133	228,746
5	1,478,982	291,385	1,261,546	448,285	291,385	291,385	25,882	34,790	230,713
6	1,261,546	291,385	1,033,238	448,285	291,385	291,385	22,077	36,529	232,779
7	1,033,238	291,385	793,514	448,285	291,385	291,385	18,082	38,356	234,948
8	793,514	291,385	541,805	448,285	291,385	291,385	13,887	40,274	237,225
9	541,805	291,385	277,510	448,285	291,385	291,385	9,482	42,287	239,617
10	277,510	291,385	0	448,285	291,385	291,385	4,856	44,402	242,127

### Assumptions:

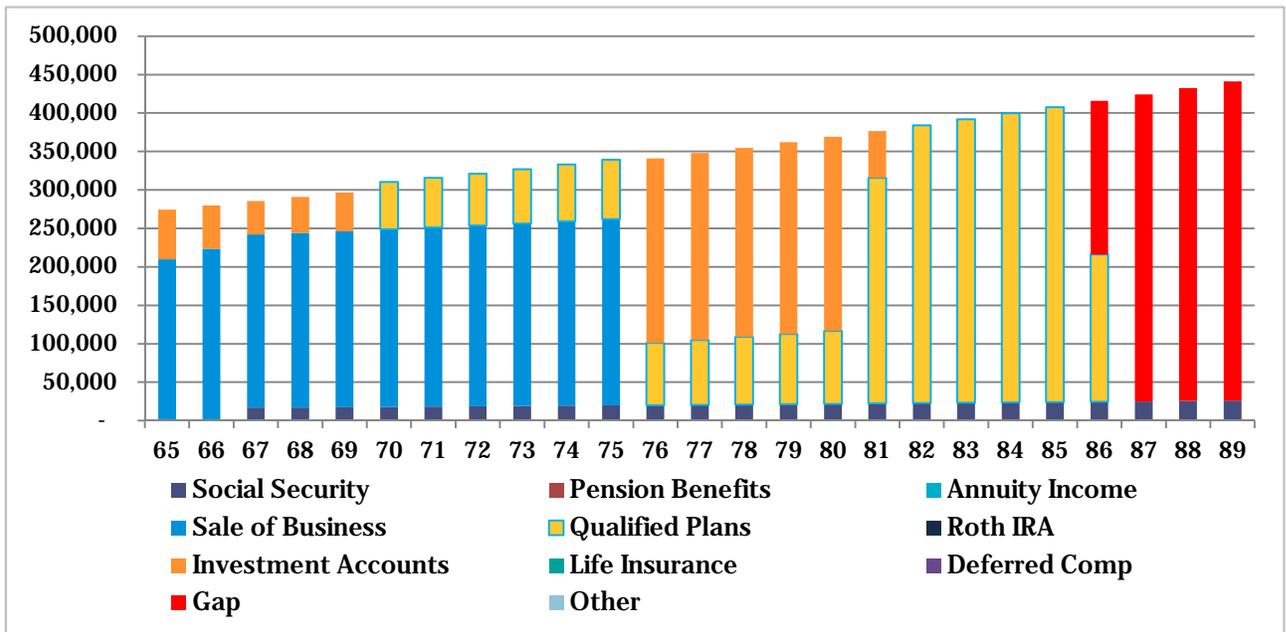
Business Value	\$2,500,000
Minus: Down Payment	\$250,000
Note Value	\$2,250,000
Note Term	10
Note Interest Rate	5%
Seller's Basis	\$500,000
Seller's Income Tax Rate	35%
Seller's Capital Gains Tax Rate	20%
Buyer's Income Tax Rate	35%

# Achieving your retirement income goal

What will it take to generate the retirement income you need? We have shown you what you can expect to receive from the proposed sale of your business. Now, let's add in Social Security, qualified plans and your existing savings and investments and see what that looks like.

## Assumptions:

Retirement Age	65	Business Value	\$2,500,000
Income to Age	90	Qualified Plans & Taxable IRAs	\$1,000,000
Annual retirement income need	\$300,000	Roth IRA Balance	\$0
Inflation Rate	2.0%	Investment Account Balance	\$500,000
Pre-Retirement Rate of Return	6.0%	Annual Deferred Comp Distributions	\$0
Post-Retirement Rate of Return	5.0%	Annual Life Insurance Distributions	\$0
Annual Social Security Income	\$24,000	Annual Pension Benefits	\$0
Annual Other Income	\$0	Annual Annuity Benefits	\$0



**Your estimated retirement gap if you retire at age 65 is \$565,958**

## Can you bridge the retirement gap?

Yes, especially if you plan now! Here are your primary options.

- Work longer. (We know this is not the ideal option, but one to consider, nonetheless.)
- Save more. Consider implementing a nonqualified supplemental retirement plan that may be a tax-efficient way to create additional annual retirement income.
- Consider activities that will increase the market value of your business by \$565,958 (net of capital gains).

## Gap solution: supplemental retirement plan



Now that we've identified that there is a gap between what you have in place for retirement income and what you will likely need, let's look at a possible solution.

A nonqualified supplemental retirement plan can be set up through your business to provide a potentially tax-advantaged way to supplement your retirement with additional income.

### How it works

- You select an amount to contribute on an after-tax basis.
- Your contributions are used to fund a personally owned asset which finances the plan.
- You can utilize company cash flow to fund the plan.
- At retirement, you can access the values accumulated in the plan to supplement your income.

Plan designs differ based on your personal, business and plan objectives. Distribution details and specific benefits vary by plan design. But, we can help you sort through all that and assist you in designing a plan that meets your specific needs. We'll consider:

- Your business entity type (e.g., S corporation, LLC)
- Additional participants you may want to include in the plan
- Impact the plan may have on your business transition strategy
- Tax impact to you and the business during both accumulation and distribution phases
- Plan financing preferences

## Nonqualified plan solution: Principal S Owner Plus<sup>SM</sup>

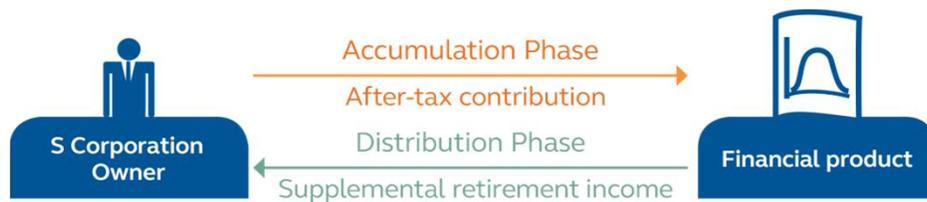
Based on our understanding of your objectives and preferences, we are recommending a Principal S Owner Plus plan to address your supplemental retirement income needs.

As an S corporation owner, your business will likely play a key role in providing personal retirement income. Most financial professionals say you will need at least 80% of preretirement earnings to comfortably maintain your pre-retirement standard of living. However, due to the limitations on qualified plans, many S corporation owners discover considerable income gaps when setting their retirement goals.

The Principal S Owner Plus plan can help fill the retirement gap by providing tax leverage similar to a Roth IRA without the restrictions on compensation and contribution limits. The tax leverage is with the life insurance product used to finance the plan, rather than being based on a tax code provision.

### How it works

You select an amount to contribute on an after-tax basis. Your dollars are used to finance the personally owned asset. Contributions can be treated as a bonus or dividend, subject to reasonable compensation regulations. At retirement, you may access the values in the financial product to supplement retirement income.



### Benefits and considerations

- S corporation owners may choose to take income as compensation or dividend income, allowing some payroll tax leverage
- If there is more than one owner, and dividend income is used, distributions need to be in proportion to ownership.
- Contributions must meet reasonable compensation regulations
- You must be able to qualify for life insurance
- Whether profits are distributed or retained for business expansion, the owners are taxed currently
- While qualified plans and Roth IRAs offer tax benefits, there are limits on compensation and contributions

### Financing options

If unable to qualify for life insurance, other financing options are available which will result in different tax implications regarding accumulations and distributions.

# Protect your retirement by protecting your business

As a business owner, you've probably had to deal with things you weren't expecting. With so much of your retirement income hinging on your business, you need to protect both you and your business from the unexpected.

## Start with your buy-sell plan

We talked earlier about the importance of determining to whom, how and when you want to transition your business. Those decisions should be documented in a buy-sell agreement that aligns with your goals.

In our experience, we have found that fewer than 15% of buy-sell agreements in place include a mandatory purchase option for when the owner retires.<sup>1</sup> It's important to address and fund the agreement not only to protect against your unplanned death, but also for other planned and unplanned exits – including retirement. So, life and disability buy-out insurance should be considered to fund your buy-sell agreement. A complimentary review by Principal of your buy-sell agreement can guide you through this process.

## Protect your most important assets – you and key employees

Have you thought about the financial impact to your business if you lost a key employee? Currently, only 42% of business owners have a business protection plan in place, leaving them exposed to risk.

Key person insurance can help. It's a simple, yet effective way to ensure your business has the necessary funds to deal with the loss of a key employee through death or disability.

Using cash-value life insurance policies (owned by the company) can also provide other benefits:

- Establishing a sinking fund for a down payment for a purchase occurring at retirement.
- Serving as a method to retain and reward key employees, thus helping to protect the value of your company as you transition into retirement.

## What if you became too sick or hurt to work?

How would you pay the utilities, lease/rent or employees' salaries? Would you have to spend your hard-earned savings or your retirement assets to make ends meet?

Unexpected events don't have to threaten your business, your current lifestyle or your retirement security. Individual disability insurance solutions are available to help you throughout the period of your unexpected disability:

- **Individual disability income insurance** – provides a monthly benefit that works like a paycheck to help you pay your personal bills and maintain your lifestyle
- **Disability retirement protection** - allows you to continue saving for retirement by investing benefits into an irrevocable trust.
- **Overhead expense insurance** – reimburses you for fixed business expenses
- **Business loan protection** – covers the cost of business-related loans when attached as a rider on overhead expense insurance

<sup>1</sup> Based on review of 720 buy-sell agreements by Principal, January 1, 2011 – July 31, 2014.

## Your customized action plan

So, you might be wondering how to get started. We've outlined the following planning strategies that are based on your specific retirement income needs, business transition goals and assets you already have in place. Now it's time to outline your priorities and set some target dates.



	Ranking	Target Date
<b>Company-level strategies</b>		
<b>Qualified retirement plan</b> - maximize contributions to your qualified retirement plan (e.g., 401(k)).	<input type="text"/>	<input type="text"/>
<b>Supplemental retirement income</b> - Implement a nonqualified supplemental retirement plan for you and your key employees.	<input type="text"/>	<input type="text"/>
<b>Buy-sell agreement</b> - Document your transition plans and fully fund your agreement with life and disability insurance.	<input type="text"/>	<input type="text"/>
<b>Key person insurance</b> - Purchase policies on all owners and key employees integral to the success of the business.	<input type="text"/>	<input type="text"/>
<b>Personal-level strategies</b>		
<b>Investments</b> - Contribute to your financial well-being with mutual funds, stocks and bonds.	<input type="text"/>	<input type="text"/>
<b>Annuities</b> - Purchase protection against outliving a specific income stream.	<input type="text"/>	<input type="text"/>
<b>Cash-value life insurance</b> - Purchase death benefit protection for your family that includes living benefits for retirement and your business transition goals.	<input type="text"/>	<input type="text"/>
<b>Disability insurance</b> - Purchase protection for your income and your business during an unexpected illness or injury	<input type="text"/>	<input type="text"/>
<b>Legacy planning</b> - Review the impact your retirement plans will have on the legacy you intend to leave to your heirs	<input type="text"/>	<input type="text"/>

## You benefit from working with a partner that 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.<sup>1</sup>
- Provider of complimentary business market administrative services for more than 30 unique program designs and over 13,500 plans.
- Preparer of more than 7,500 informal business valuations since 2011.
- Reviewer of more than 1,000 buy-sell agreements since 2011.

<sup>1</sup> Based on total number of nonqualified deferred compensation plans, PLANSPONSOR 2015 NQDC Buyer's Guide.



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