



Buy-Sell Agreements

Plan for Best, Prepare for Worst

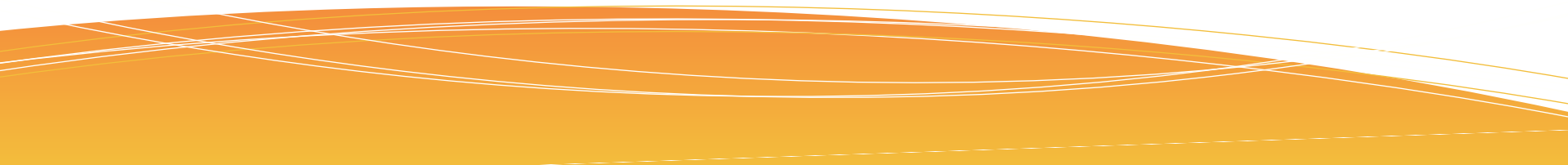
Presented By:

Kent Pummel, CPA/ABV, CVA

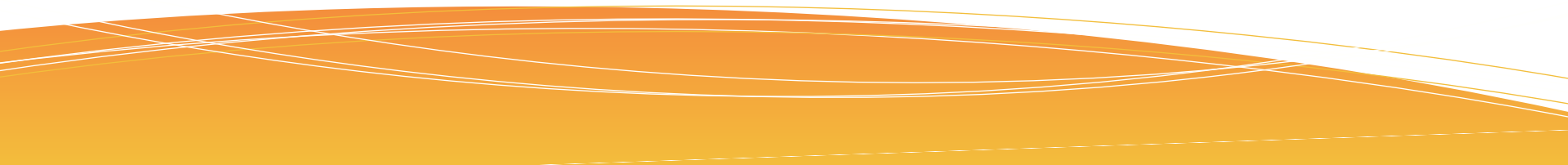
Buy-Sell Agreements

- Discuss importance of buy-sell agreements
- Identify 3 types of agreements
- Strengths and weaknesses of each agreement
- Level and standard of value used
- Treatment of insurance proceeds and other related property

Based on presentation by Z. Christopher Mercer and his book *“Buy-Sell Agreements”*



Buy-Sell Agreements

- Part of lifetime exit process
 - Require agreement at a point in time
 - Should be coordinated with other agreements (operating agreements, etc.) to avoid conflicts
 - One size does not fit all!
 - Beware of pitfalls
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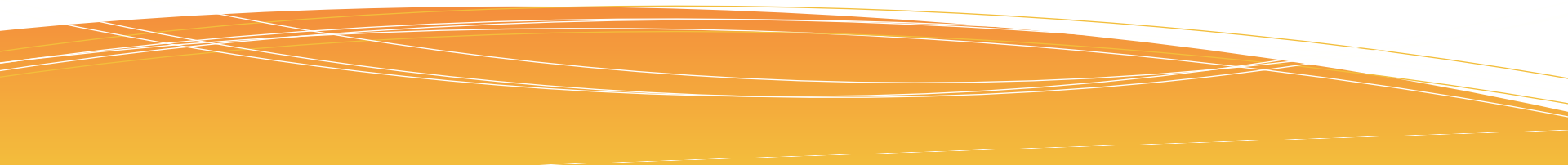
Types of Buy-Sell Agreements

- Fixed Price Agreements
- Formula Agreements
- Process Agreements

Fixed Price Agreements

- Advantages
 - Easy to understand
 - Inexpensive
- Disadvantages
 - Outdated when issued
 - One is betting other will die first (therefore less money)
 - May be difficult to change over time

Fixed Price Agreements

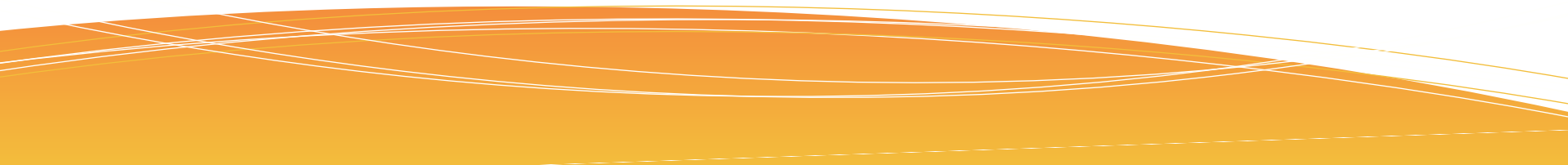
- What is date of agreement?
 - Signed by all parties?
 - Has the fixed price been updated?
 - Is the fixed price calculation reasonable still?
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Formula Agreements

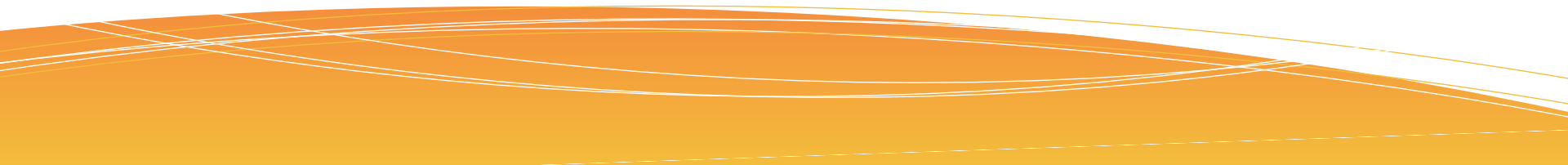
Single formula applied to balance sheet or income statement

- Advantages
 - Easy to understand
 - Inexpensive
- Disadvantages
 - No formula at one point will hold up over time
 - Does not factor in changes to business, industry, economy
 - If not clearly defined the multiple can be calculated incorrectly

Formula Agreements

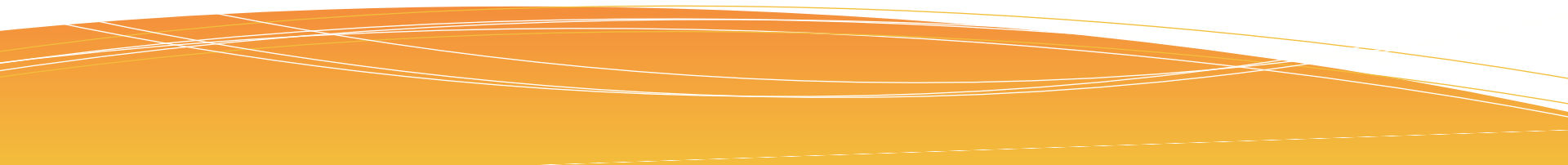
- What is date of agreement?
 - Is agreement signed?
 - Is there an example calculation in agreement?
 - Who will make the calculation in the agreement?
 - Any adjustments to be made to income statement or balance sheet during calculation?
 - If 2 appraisers calculated, would value be the same?
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Formula Agreement

- *Estate of Maurice F. Frink* (Iowa App. 2006)
 - Use of “book value” in the buy-sell agreement
 - Beneficiaries argued that “book value” actually meant fair market value, resulting in greater value to beneficiaries
 - Court used book value, since this was used with prior redemptions
 - As you can see, certain formulas (like book value) exclude the value of goodwill from the calculation
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Process Agreements

Valuation process with one or more appraisers

- Advantages
 - Calculates proper value at date of triggering event
 - Understood by attorneys who know downfalls with formula and fixed arrangements
 - Disadvantages
 - More expensive
 - Distracting for management
 - Need to identify what standard and level of value are in agreement
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Other Buy-Sell Issues

- Standard of Value
 - Type of value used
 - Most of the time is “fair market value”
 - Can also be “fair value” or “investment value”
 - If not “fair market value”, clearly define what “fair value” or “investment value” means

Other Buy-Sell Issues

- Level of Value
 - Control value? Marketable minority value? Non-marketable minority value?
 - If not defined up to appraiser to determine
 - Be sure owners agree and fix it
 - May make sense to have chart showing the level of value

Other Buy-Sell Issues

- Insurance proceeds
 - Typically used by owners for buy-sell arrangements
 - Updating value in agreement validates the amount of insurance held
 - Should insurance proceeds be considered asset of business or not?
 - Can have impact on value calculation so should clearly define

Opportunity as Advisor

- Talk to clients about importance of buy-sell agreements
- Improve the buy-sell agreements to help your clients and referral sources

Buy-Sell Agreements

- Four key components to agreement per Mercer
 - Understandable
 - Predictable
 - Achieve reasonable solution
 - Helpful in wealth management process

Certified Public Accountants

- Suggestions
 - Single appraiser (Clark Schaefer Hackett of course!)
 - Select now, value now
 - Allows value to be calculated and dissected to make sure calculated as intended by all parties
 - Should remove any potential issues from lack of clarity in agreement
 - Value regularly
 - Subsequent appraisals should be cheaper

Questions?
Thank you!



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