Informal Business Valuation and Business Planning Report

Connecting business value to your success

Presented to

Valued Company

Based on financials from 2017 - 2019

Presented by

Principal Financial Group

Protect your success

You can be proud of the business you've built and its success. You've worked hard, so you want to make sure that the business plans you have for the future can be realized.

There are three key components to effective planning:

1 | **Knowing the value of your business.**

2 | **Protecting your business and your key employees –** Business succession and business protection plans allow you to prepare for the unexpected, as well as the future success of your business. And, retention and retirement solutions can also help you and your valuable key employees.

3 | **Protecting your lifestyle –** Retirement, income protection and legacy and estate planning solutions help you and your family maintain your lifestyle.

That may sound like a lot to think about. But, that's where Principal® comes in. We're here to help you implement proper business planning, and to offer simple processes to help keep those plans current.

You've already taken the first step

Because the value of your business is such an integral part of effective planning, that's a great place to start. You probably have a good idea of what your business is worth. But, if you're like a lot of other business owners, you may not have ever had your business valued. So, the informal business valuation that follows is a great start towards protecting your business' future success.

Let us help you with the rest

The rest of the content in this report is intended to help you with the protection aspect of the planning process – protecting your business, your key employees and your lifestyle.

- **Protecting your business and key employees –** An important part of this is planning for the future, which includes having a formal business succession plan in place. It's the best way to help ensure that your business will continue in your absence, on your terms. This is something many business owners don't address. In fact, 44% of growing businesses don't have an exit or continuation plan in place.[1]

  Even though the top two transition events for businesses are death and disability of an owner, many buy-sell agreements we've reviewed fail to make these mandatory trigger events. Death is a mandatory buy-out event for 71% of agreements. But for disability, that percentage drops to only 34%.[2]

- **Protecting your lifestyle –** Protecting the value of your business is key for this. It's important to your company's overall success should something unexpected happen. But, you also want to protect the business that's likely a source of income for you and your family, as well as planned retirement income for you. We know this type of planning is easy to avoid, so that's why we've identified some planning solutions to help you get started.

This comprehensive report is meant to be a guide for the long-term future of your business. It starts out with the informal valuation of your business, then highlights possible solutions and next steps needed to create effective plans specifically for your business. And, knowing you probably can't do everything at once, we'll help you prioritize your next steps.

We look forward to working with you to put a plan in place that will help ensure your business will meet the goals you have set, and thrive under many contingencies.

[1] 2019 Principal Financial Group® Business Owner Survey, conducted by Harris Insights & Analytics.
[2] Review of 1,561 buy-sell reviews by Principal Financial Group (1/01/2014 to 1/31/2018).

Know the value of your business

Determining the value of your business is the starting point and an integral part of the planning process. There are many different methods to value a business, but there's no one method that's always appropriate. At the end of the day, the "fair market value" of a business is the amount agreed upon by a willing buyer and a willing seller. Neither party is under any compulsion to buy or sell, and both must have reasonable knowledge of all the relevant facts. This is a common definition used for valuing a business, but we'll try to add a little more clarity to it below.

Valuation approaches and methods

Business valuation methods are generally categorized under three approaches: asset approach, income approach, and market approach. Since no single method is most appropriate for valuing every business, it's common to reference a business valuation method under any one or all three approaches.

Asset approach

This is typically used with businesses that have substantial tangible assets, usually in the form of inventory and equipment. It's most appropriate for businesses with a substantial amount of fixed assets.

Adjusted book value – This generally represents the "liquidation" value – assets, with adjustments, less liabilities.

Income approach

This type of approach uses prior earnings to estimate company value based on income potential. It's most appropriate for businesses with consistently strong earnings. Specific methods include the following:

Capitalization of earnings method – Applicable for consulting-type businesses and/or those with few or no tangible assets.

Excess of earnings method – Generally for manufacturing-based firms with significant assets.

Discounted cash flow method – Uses projected values. Projected future earnings are forecast, then discounted using an appropriate rate representative of the "next best investment opportunity" with a comparable level of risk. Used mainly for mergers and acquisitions.

Multiple of discretionary earnings method – Applicable for more service-oriented firms, such as legal, accounting, healthcare systems, dental, engineering, etc. Goodwill of the owner(s) has a significant impact on value.

Considerations for valuing a business per IRS Revenue Ruling 59-60

- Nature and history of business
- Outlook of 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

Market approach

This is based on the prices of similar or comparable businesses that have recently sold. This data is more challenging to find for the sale of small businesses and professional practices, rather than for large businesses. **A valuation using this method is not provided in this report.**

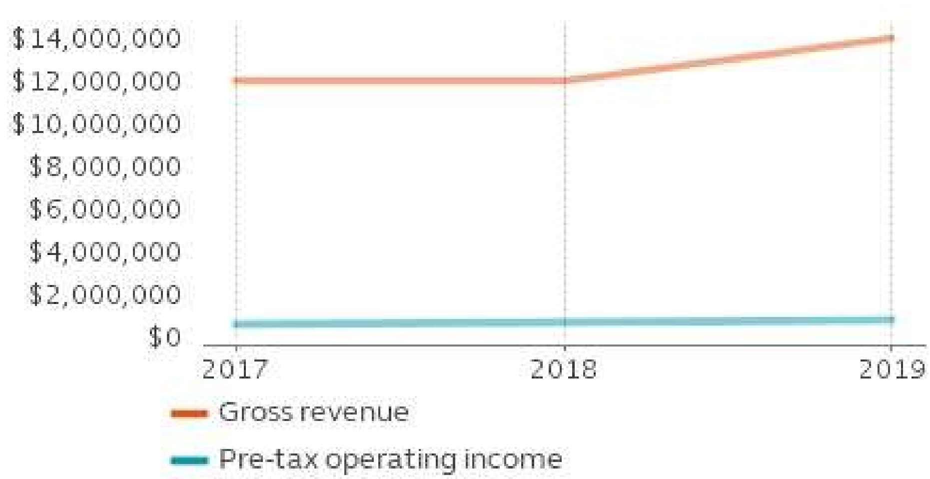
Your company profile

Entity type:	S Corporation
Industry:	Service Industry
State:	IA
Years in business:	12
Number of business owners:	2
Number of employees:	11-50
Family business:	Yes
Number of children active in business:	3
Number of children not active in business:	2

Financial statement summary

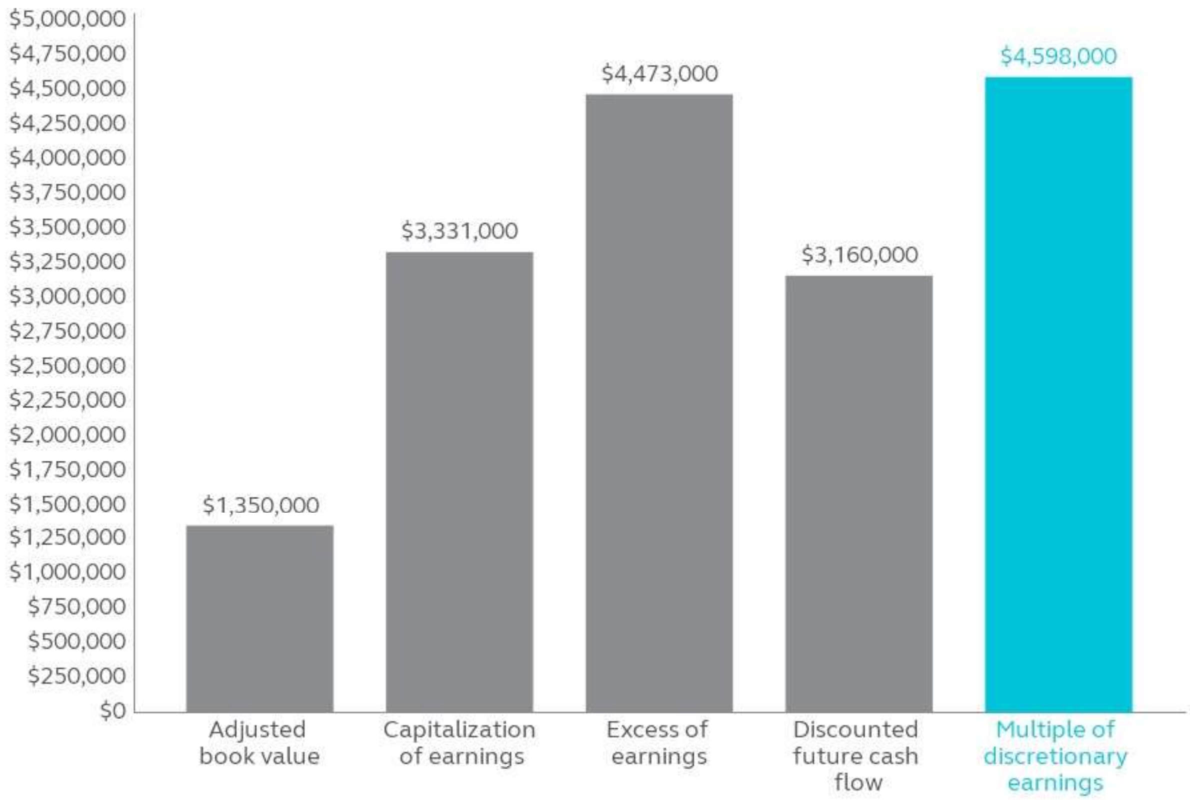
This summary of your provided financial information was used to calculate the business valuations that follow.

Income	2017	2018	2019
Revenues	$12,049,000	$12,000,000	$14,009,000
Pre-tax operating income	$599,000	$650,000	$740,000
Depreciation	$110,000	$110,000	$110,000
Owner compensation	$250,000	$264,000	$280,000



Your informal business valuation

We've provided values using five generally accepted methods of valuation. Your company profile suggests the highlighted value below may be most appropriate for your business.



Adjusted book value method Assets, with adjustments, less liabilities - generally represents the "liquidation" value	$1,350,000
Capitalization of earnings method Amount of capital that would have to be invested at a specified rate to yield the current average net annual earnings of the business	$3,331,000
Excess of earnings method A combination of the adjusted book value and capitalization of earnings methods	$4,473,000
Discounted future cash flow method Projected future business earnings forecast, then discounted using an appropriate rate	$3,160,000
Multiple of discretionary earnings method Earnings provided by goodwill, times a multiplier; adjusted book value is added to this number	$4,598,000

Calculations

Assumptions

Average operating income:	$796,000
Excess owner compensation[1]:	$70,000
Capitalization rate:	26.0%
Rate of return on assets:	4.0%
Earnings multiplier:	4
Number of years to forecast:	4
Discount rate:	15.0%
Growth rate:	8.0%

Adjusted book value method	
Book value	$1,350,000
Plus adjustments +	$0
Adjusted book value	$1,350,000

Capitalization of earnings method	
Average operating income	$796,000
Plus excess owner compensation +	$70,000
Total	$866,000
Divided by capitalization rate ÷	26.0%
Capitalization of earnings	$3,330,769

Excess of earnings method	
Average operating income	$796,000
Plus excess owner compensation +	$70,000
Less adjusted book value multiplied by rate of return on assets -	$54,000
Total	$812,000
Divided by capitalization rate ÷	26.0%
Excess of earnings on assets	$3,123,076
Plus adjusted book value +	$1,350,000
Excess of earnings	$4,473,076

Discounted future cash-flow method	
Average operating income	$796,000
Plus excess owner compensation +	$70,000
Total	$866,000
Growth rate	8.0%
Number of years to forecast	4
Discount rate	15.0%
Discounted future cash flow	$3,160,000

Multiple of discretionary earnings method	
Average operating income	$796,000
Plus excess owner compensation +	$70,000
Less adjusted book value multiplied by rate of return on assets -	$54,000
Total	$812,000
Multiplied by earnings multiplier x	4
Total goodwill	$3,248,000
Plus adjusted book value +	$1,350,000
Multiple of discretionary earnings	$4,598,000

[1] Excess owner compensation is defined as salary over and above what the owner would pay a key employee to perform similar services that the owner is now performing, without incurring the additional risk of business ownership.

Special considerations for family-owned businesses

Transitioning a family-owned business such as yours can be tough. The most challenging part is often balancing the competing needs of your family members:

- Providing sufficient retirement income for exiting owner
- Leaving a healthy business to support itself and your successor
- Assuring other family members of an equitable inheritance

So how do you successfully plan for a transition from generation to generation? Start with a plan that includes a well-drafted buy-sell agreement that covers all the triggering events. Then, make sure that it's adequately funded for your goals and your business.

Inheritance equalization

For many owners, it's important to treat children equally when leaving an inheritance. But, if a large portion of your estate is your business, you may feel like you're trying to divide the indivisible. While the inheritance you leave each child might not be identical and equal, it can still be fair and equitable.

We can help you evaluate your specific situation and determine what a fair distribution looks like to your family. Our Family Business Planning Report reviews your current plan and then shows a proposed plan for helping you treat your heirs equitably.

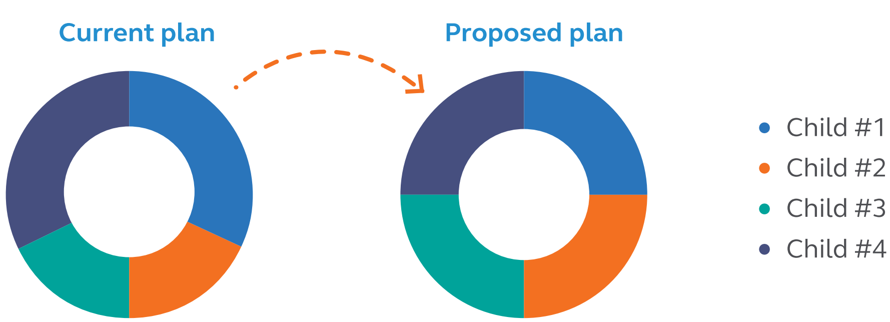
Sample inheritance equalization analysis from Family Business Planning Report

Current plan

Type	Total	Child #1	Child #2	Child #3	Child #4		
Business assets	$8,000,000	50%	0%	0%	50%	0%	0%
Other assets	$4,500,000	0%	50%	50%	0%	0%	0%

Proposed plan

Type	Total	Child #1	Child #2	Child #3	Child #4		
Business assets	$8,000,000	50%	0%	0%	50%	0%	0%
Other assets	$4,500,000	0%	50%	50%	0%	0%	0%
New insurance	$3,500,000	0%	50%	50%	0%	0%	0%



Federal estate tax considerations

If you are subject to federal estate taxes due to the size of your total estate, there are special concerns about the valuation of your family-owned business. Because the federal estate tax is imposed on each generation,[1] one of the owners' goals might be to use the buy-sell agreement to establish a value that will be respected for federal estate tax purposes. This is known as "locking in" the value of the business.

Valuing requirements

To lock in the value of the business, the buy-sell agreement must meet these requirements:

- Price must be fixed or formula-based under the agreement.
- Estate must be obligated to sell at death at the agreement price.
- Agreement must prohibit the owner from disposing of his or her interest during life without first offering it to the other party or parties at no more than the agreement price.

Special requirements for family-owned business buy-sell agreements

The IRS will pay extra attention to the valuation aspects of any business-interest transfer among family members for estate tax purposes. You might keep the IRS from setting its own value of your business by following these primary rules:

- Do not use the agreement as a device to transfer property to family members for less than full and adequate consideration.
- Ensure the agreement value is comparable to similar arrangements entered into by persons in arm's-length[2] transactions.
- Ensure the buy-sell agreement is a bona fide business arrangement and not a device to pass the interest to heirs without full and adequate consideration.

[1] The federal estate tax lifetime exclusion amount is $11,580,000 in 2020, as indexed.

[2] The arm's length principle is the condition or fact that the parties to a transaction are independent and on an equal footing. Such a transaction is known as an arm's-length transaction.

Gifting

Many owners of family businesses have legacy and estate planning goals that involve transferring assets through gifting. Gifting techniques can help you accomplish a variety of potential estate planning goals:

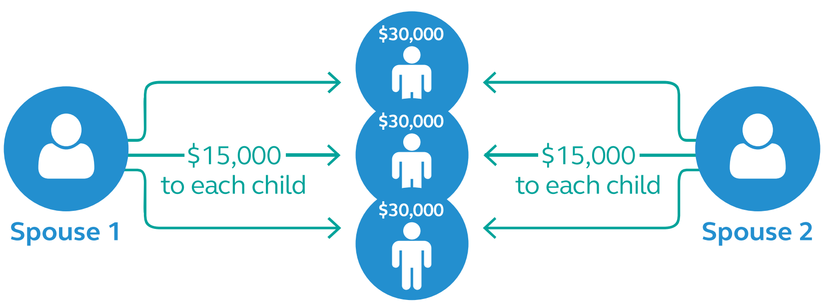
- Reduce federal estate taxes.
- Facilitate your business succession plan.
- Provide immediate use of the gift.
- Make additional support available to loved ones.
- Move future appreciation out of the taxable estate.

Again, our personalized planning report looks at current federal gift tax exclusion amounts and calculates how much in taxable assets could potentially be removed from your estate.

Sample gifting calculation from Family Business Planning Report

Example

A married couple with three children could gift $90,000 annually.



Your scenario

Number of donors		Your number of beneficiaries		2020 annual gift exclusion amount		Combined annual gift exclusions
2	x	3	x	$15,000	=	$90,000

Protect your business with a buy-sell agreement

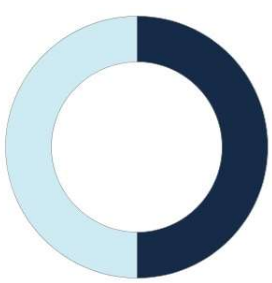
A properly funded and current buy-sell agreement helps business owners make sure they have the right amount of money, in the right place, at the right time.

With a little coaching from Principal, you can design a buy-sell agreement which does the following:

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

Important features of a buy-sell agreement

- 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 income insurance policies



Business ownership

Owner	Ownership %	Value today	Estimated future value[1]
Jesse Jones	50.00%	$2,299,000	$3,377,985
Pat Smith	50.00%	$2,299,000	$3,377,985

[1] Estimated future value is based on a 8.0% growth rate and 5 year(s) in the future.

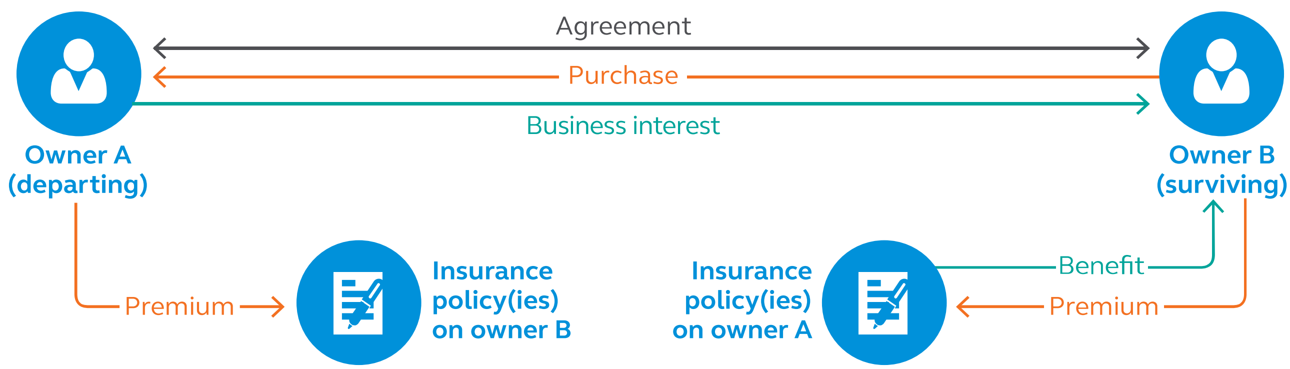
You may want to consider the following business succession solutions.

Cross purchase buy-sell agreement

A cross purchase buy-sell agreement can help protect the future of your business. It arranges for the remaining owners (rather than the business) to purchase a departing owner's interest. The purchase can be triggered by death, disability, divorce, retirement, or other events.

Here's how it works

Once the agreement is in place, each owner purchases a life and/or disability insurance policy on each of the other owners. Each owner is the premium payer and beneficiary of the policies he or she owns. Upon the triggering event, the remaining owners purchase the departing owner's business interest using policy cash values or benefits from the policy.



What you need to know

There are advantages to this sort of an agreement, just as there are some other things to consider.

Taxes could be minimized upon a subsequent sale – Insurance proceeds are received income tax-free. Remaining owners receive an increased cost basis as a result of the purchase price paid to the departing owner.

Business may pay premiums – Dollars used to pay premiums are taxable as a bonus to the policy owner and are generally deductible to the business.

Multiple policies may be necessary on each owner – If there are more than two business owners, multiple policies on each are required. Each business owner is the owner, premium payer, and beneficiary of policies on each of the other owners. So, if there are multiple business owners, this may become cumbersome.

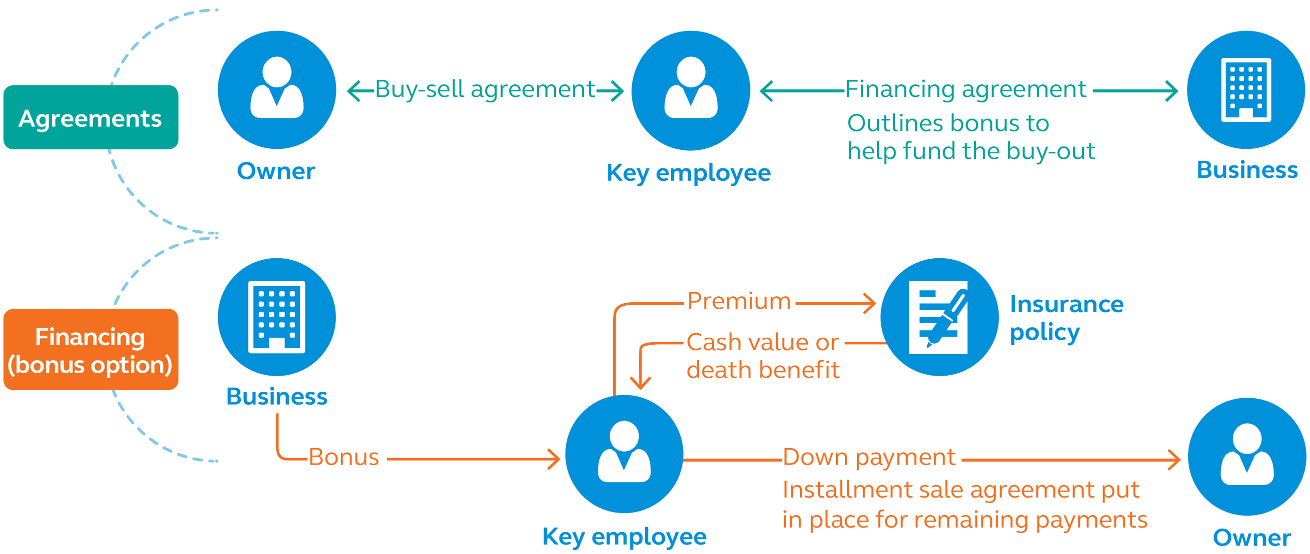
Tax implications can vary by triggering event – Family members generally receive an adjusted basis following an owner's death. For disability or other lifetime triggering events, the selling owner may recognize capital gain.

Principal Select Buy-Out℠ Plan

A Principal Select Buy-Out Plan can help protect the future of your business. This type of arrangement identifies a successor, often a key employee, and offers control and flexibility in the timing and financing of the buy-out. The purchase can be triggered by your death, disability, retirement, or other departure.

Here's how it works

Once the agreement is in place, a life insurance policy is purchased to finance the future buy-out. This can be owned and financed in one of two ways: by the business or by the key employee. Either way, the policy can accumulate liquidity that can be used by the key employee to meet down payment requirements upon a triggering event.



What you need to know (bonus plan option)

There are advantages and considerations for this flexible sort of agreement, no matter which financing option you choose.

Business receives a current tax deduction – Business bonuses the premium to the key employee as compensation. This bonus is tax deductible.

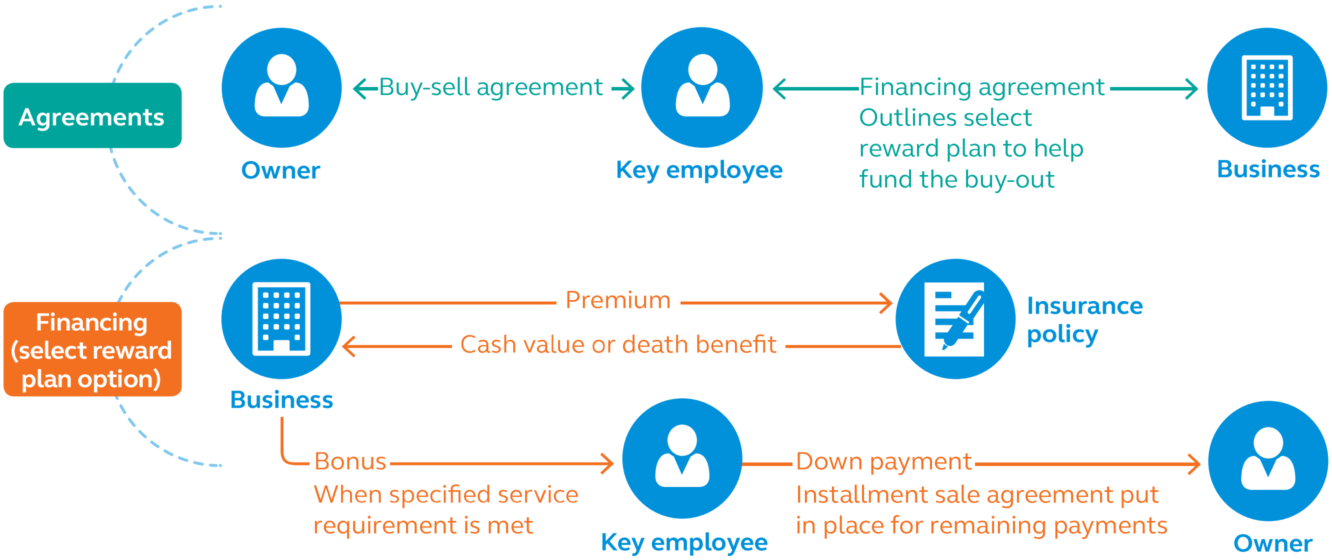
Key employee owns the insurance policy – Personal beneficiaries may receive tax-free benefits upon the key employee's death.

Key employee pays taxes – Taxes must be paid on bonuses from the business.

Key employee makes down payment – Employee begins the buyout using funds from the insurance policy.

Key employee can reduce risk – Key employee may consider purchasing term life insurance on the current owner. This could provide tax-free proceeds should the owner die prior to completion of the sale.

Principal Select Buy-Out Plan (continued)



What you need to know (select reward plan option)

There are advantages and considerations for this flexible sort of agreement, no matter which financing option you choose.

Business owns the insurance policy – Business pays the premium with after-tax dollars. Should the key employee die, the business receives the income tax-free death benefit which can be used to help recover costs.

Encourages loyalty – Provides an incentive for the key employee to remain loyal to the organization for a predetermined service period.

Business receives a tax deduction – In the year the bonus is paid or the life policy is transferred to the key employee, a tax deduction is received for the entire bonus.

Key employee pays taxes – Upon meeting the service requirement, taxes must be paid on the bonus from the business.

Key employee can reduce risk – Key employee may consider purchasing term life insurance on the current owner. This could provide tax-free proceeds should the owner die prior to completion of the sale.

How to fund a buy-sell agreement

Buy-sell agreements involve the selling and buying of the departing owner's business interests according to the terms of the formal agreement. This means money will be needed to complete the transaction when it occurs. So, it's best to have a plan for securing that money. There are basically five options for this.

Funding methods

Cash – Requires sufficient cash flow to pay the full price in a lump sum.

Loan – Involves unknown factors such as future credit availability and cost of borrowing. Borrowed funds must be repaid (with interest) from earnings. A down payment is generally required.

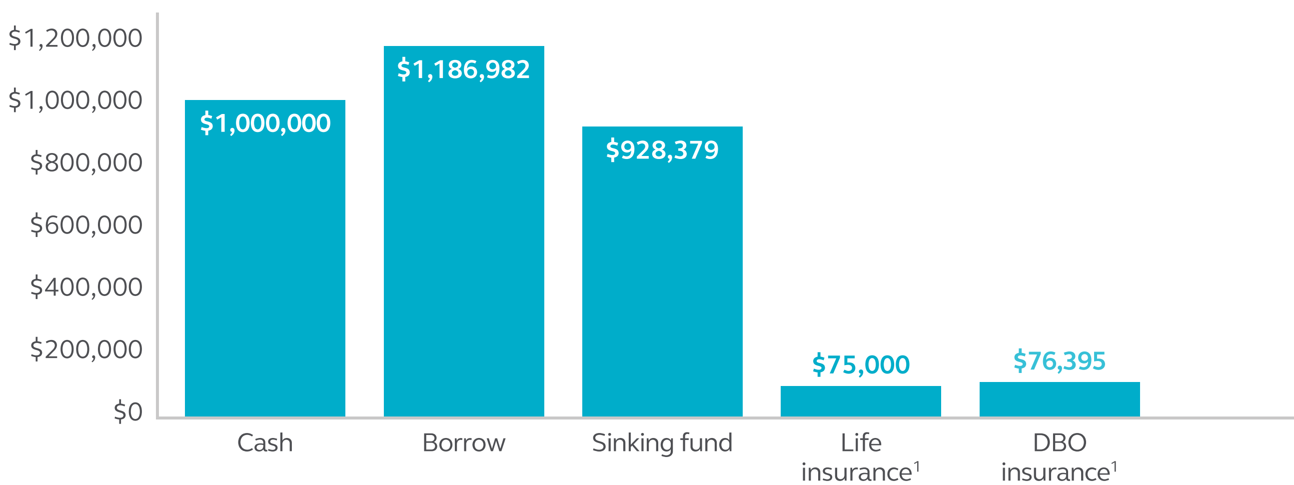
Savings – Doesn't assure that sufficient funds will be available when needed because of unpredictable departure timing.

Installment sale – Requires repayment from earnings and is contingent on future success of the business.

Insurance – Provides liquidity when purchased upon the implementation of an agreement. Since the death or disability of an owner is often unpredictable and disruptive to a business, each is typically a mandatory triggering event in a buy-sell agreement.

How do you decide which method is appropriate for your situation? Timing of liquidity and cost are typically the key considerations. Compare these hypothetical protection costs for a $1,000,000 purchase price.

Hypothetical funding method cost at end of 15 years



Assumptions:

Cash	$1,000,000
Borrow	Represents five equal annual payments of $200,000 plus interest at 6%.
Sinking fund & cash	Sinking fund of $146,621 (annual deposits equal to the life insurance premiums growing at 8%) plus the balance necessary of $853,379 in cash.
Insurance	**Life –** Estimated premiums of $5,000 for Male, 45, Preferred, Non-tobacco, UL Flex III policy. **Disability Buy-Out (DBO) –** estimated premiums of $5,093 for Male, 45, Executive Occupation class DBO policy. Insurance premiums paid for 15 years. Not valid without accompanying insurance illustrations. See illustrations for important information.

[1]The amount of insurance available to purchase depends upon the value of the business. Underwriting standards for life insurance and disability coverage are different. Disability buy-out insurance may not be available for every business.

Protect your business from the loss of a key employee

In the event of a death, disability or resignation of a key employee, would your business be as successful as it is today? A business protection plan can help you prepare for the unexpected and lessen the impact of such a loss. Unfortunately, **only 46% of business owners have a business protection plan in place[1],** leaving them exposed to risk.

A business protection strategy can lower the risk. It allows you to implement a financial cushion, with cost- effective liquidity, which can help replace and/or retain key employees who critically impact the value of your business.

Are business protection solutions right for your business?

Before moving forward with a strategy, an important first step is to ask "Who exactly are my key employees?" Think about the employees in your organization who really make a difference. Consider the areas of operations, workflow, relationship management, customer relations, sales, and profitability.

Then, think about these questions:

Yes No

- ◯ ◯ Would your business be negatively impacted by the **loss of a key employee**?
- ◯ ◯ Are you interested in developing special incentives to **tie your key employees to the business** for the long term?
- ◯ ◯ Would your key employees like to **save more money** on a tax-advantaged basis?

If you answered yes to any of these questions, you can implement simple strategies to help. There are generally two types of solutions: **key person protection** and **key employee benefits**.

Key person protection

Protect the integrity, cash flow and ongoing success of your business from the loss of a key employee due to death, disability, or termination of employment. Key person insurance helps the business overcome additional expenses associated with recruiting and training a replacement.

[1] 2019 Principal Financial Group® Business Owner Survey, conducted by Harris Insights & Analytics.

Key employee benefits

Recruit, reward, retain and retire the key employees with key employee benefit plans. These plans can help you by helping them. They can provide additional benefits and/or help them make up for benefits lost due to government restrictions placed on qualified retirement plans. The result? More engaged and loyal employees and a great recruiting tool, too.

Specifically, these plans can do the following:

- Enhance your total benefits package by offering a financial reward.
- Encourage loyalty by helping to secure their financial futures.
- Give key employees an incentive to grow the business.
- Provide simplified government reporting and disclosure rules—or none at all.

Considerations for common key employee benefit plans

Business considerations	Principal® Bonus	Principal® Deferred Compensation - SERP	Principal® Deferred Compensation - Select Reward	Principal® Deferred Compensation - Defined Contribution	Principal® Loan Split Dollar
Immediate tax deduction	*Yes*	*No*	*No*	*No*	*No*
Golden handcuffs	*Limited*	*Yes*	*Yes*	*Yes*	*Yes*
Cost recovery	*No*	*Yes*	*Yes*	*Yes*	*Yes*
Administrative services	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Employer contributions	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Employee contributions	Yes	*No*	*No*	Yes	*No*

You may want to consider the following business protection solutions.

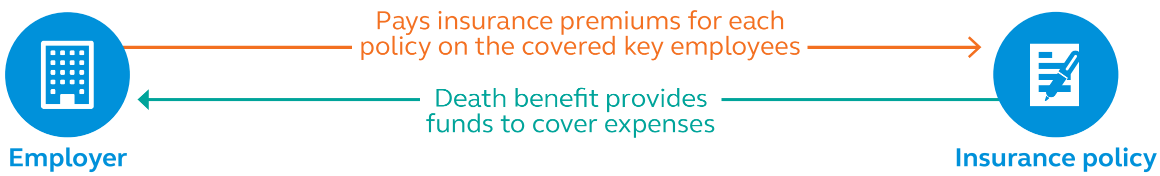
Key person life insurance

The most valuable assets of any business are often the key people who contribute most to its success. They generate revenue, handle major responsibilities, and have a unique wealth of knowledge that seems irreplaceable.

Have you considered the amount of time and money it would take to replace your top talent? If their loss would create a financial burden that puts the business at risk, a key person insurance policy can be a simple and efficient solution.

Here's how it works

Your business is the owner and beneficiary of a life insurance policy for each key employee chosen, which can include business owners. If the unexpected does happen, the business receives cash, generally income tax-free, to help overcome the financial challenges of the loss.



What you need to know

There are advantages to this sort of an arrangement, just as there are some other things to consider.

Immediate cash – So you don't have to worry about how you will pay for the loss and replacement of a key employee.

Cost efficiency – Affordable term or permanent policies may provide significant death benefits.

Cash value potential with permanent policy option – Potential cash values can remain an asset on your balance sheet or be used for other expenses, such as a key employee benefit program.

What's right for you – There are several insurance and funding options. Carefully decide what is best for your business.

Effect on your assets – Understand how significant life insurance policy holdings will affect your capital and liquidity.

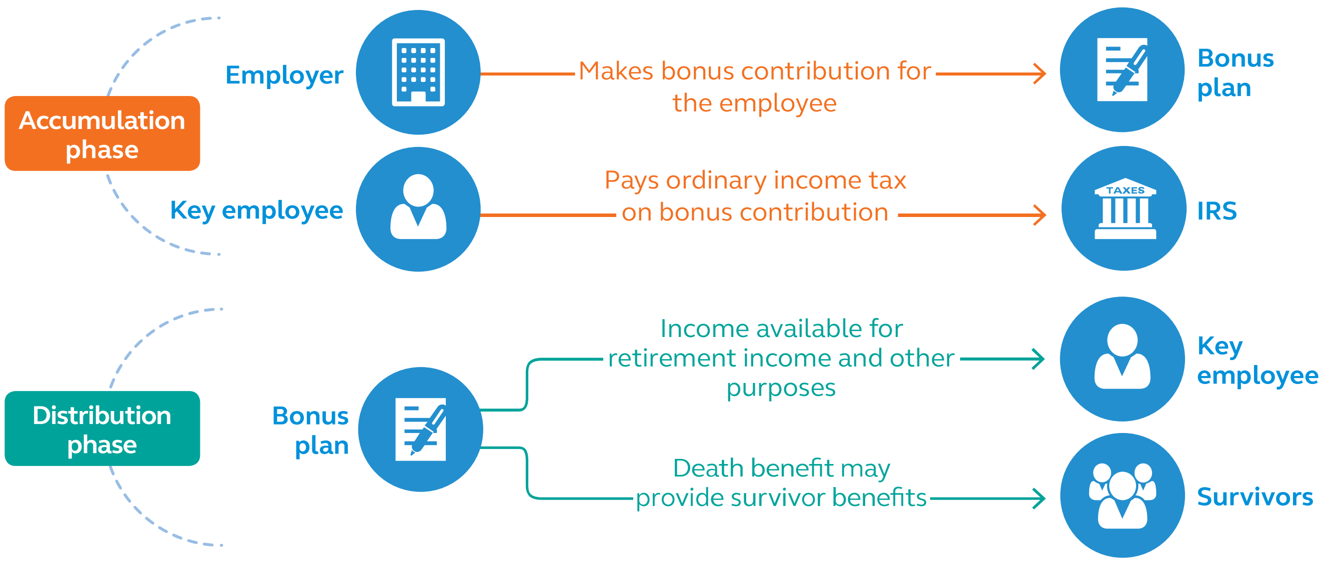
Employee retention – If keeping your key employees is a concern, consider a retention bonus plan that allows you flexibility as well as funding to protect your most valued employees under multiple scenarios.

Principal® Bonus

This retirement benefit is an incentive plan that offers your key employees multiple benefits. It helps your top talent increase their savings for the future, while helping you reward and keep them for the long term. Plus, contributions are tax-deductible to you, and it's easy to administer.

Here's how it works

Typically, the bonus you contribute to the plan for select key employees is used to buy a life insurance policy from Principal[1]. This policy funds the plan and provides retirement income, death benefit protection, as well as additional living benefits.



What you need to know

There are many advantages to this plan, just as there are some things to consider.

For you:

Increase morale – It's an effective way to recruit, reward, retain and retire the employees who are most valuable to your business.

Receive tax deduction – You receive a current tax-deduction[2] on the bonuses contributed to the plan.

Communicate easily – Its simple and flexible plan design is easy to communicate and maintain.

Save time – You save time by not having to deal with annual reporting or ERISA requirements.

Impact cash flow – Bonuses you pay reduce company cash flow.

For your key employee:

Save more – More can be saved for retirement; above the limits of a qualified plan, such as a 401(k) or 403(b).

Receive multiple benefits – Distributions may be used for planned events such as supplementing retirement income, funding a child's education or purchasing a second home. The plan can also provide access to funds to address unplanned events—such as disability, chronic illness, and other financial needs.

Enhance financial security – The employee's family may receive tax-free benefits at the employee's death.

Owns the policy – The key employee owns the life insurance policy[1], but must stay with the organization to be eligible for the bonus.

Pay potential taxes – An additional tax may be due if the employer's bonus doesn't cover all of the income tax. However, the tax on the bonus may be partially or fully offset with another employer bonus.

[1] Additional financing options may be available.

[2] Due to the flow-through tax treatment of some businesses, such as S corporations and limited liability corporations (LLCs), you may want to consider specific plans designed to benefit the owners of these entities.

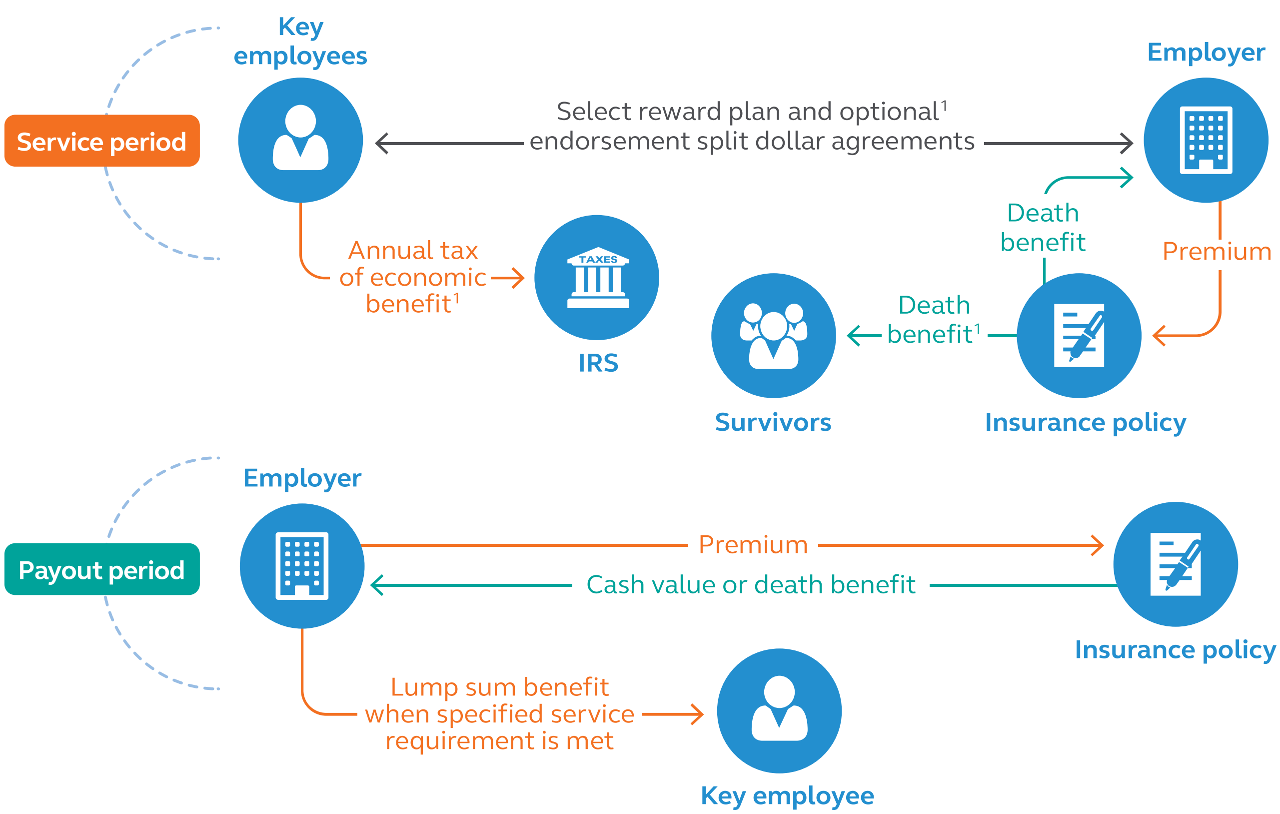
Principal® Deferred Compensation - Select Reward

This deferred comp plan could be an attractive solution for you and your key employees. It provides a lump-sum benefit to them at the end of a pre-determined service period, which encourages your top talent to stay with you for the long term, instead of exploring opportunities with your competition.

Here's how it works

A deferred comp agreement is established with select key employees. You and each key employee enter into an agreement that promises a lump-sum benefit if the employee satisfies a service requirement. The company then purchases and pays the premium on a life insurance policy that builds cash value. If desired, an endorsement split dollar agreement can be set up so that part of the policy's death benefit goes to the survivors if the key employee should die during the service period.

When the service requirement has been met, the lump-sum bonus will be paid to the key employee. You choose how the bonus will be paid. You may use current cash flow or a withdrawal of cash value from the life insurance policy to meet the bonus requirement. As an alternative, ownership of the policy can be transferred to the key employee.



[1] These items only apply if the optional endorsement split dollar agreement is used.

Principal® Deferred Compensation - Select Reward (continued)

What you need to know

There are many advantages to this plan, just as there are some things to consider.

For you:

Encourage loyalty – You provide incentive for the key employee to remain loyal to your company for a predetermined service period.

Receive a tax deduction – In the year the bonus is paid or the life policy is transferred to the key employee, your company receives a tax deduction for the entire bonus. Any gain in the policy at this time of transfer is taxable to you.

Reduce cash flow – Premiums are paid with company after-tax dollars, so each premium payment reduces your annual cash flow.

Recover the premium cost – If the key employee dies before the end of the service period, the life insurance policy's tax-free death benefit[1] may be used to recover the cost of the premiums you paid.

For your key employee:

Pay minimal cost – The key employee will pay tax on the value of the life insurance death benefit that's endorsed to them during the service period. This cost is much less than if the key employee was to personally purchase that amount of life insurance.

Help with taxes – This plan design does not allow the option to defer the lump sum bonus, nor does it offer another payment choice. In the year the bonus is received, the key employee recognizes income in the amount of the lump sum bonus. However, the policy's cash value may be used to pay the income tax due.

Use for personal needs – If ownership of the life policy is transferred to the key employee, its cash value and death benefit may be used for personal financial needs.

Must qualify – The key employee must be healthy enough to qualify for the life insurance policy.

Note: The bonus must be paid in a lump sum within 2½ months of the end of the tax year in which the key employee meets the service requirement to avoid being considered a deferred compensation plan that would be subject to IRC Section 409A requirements.

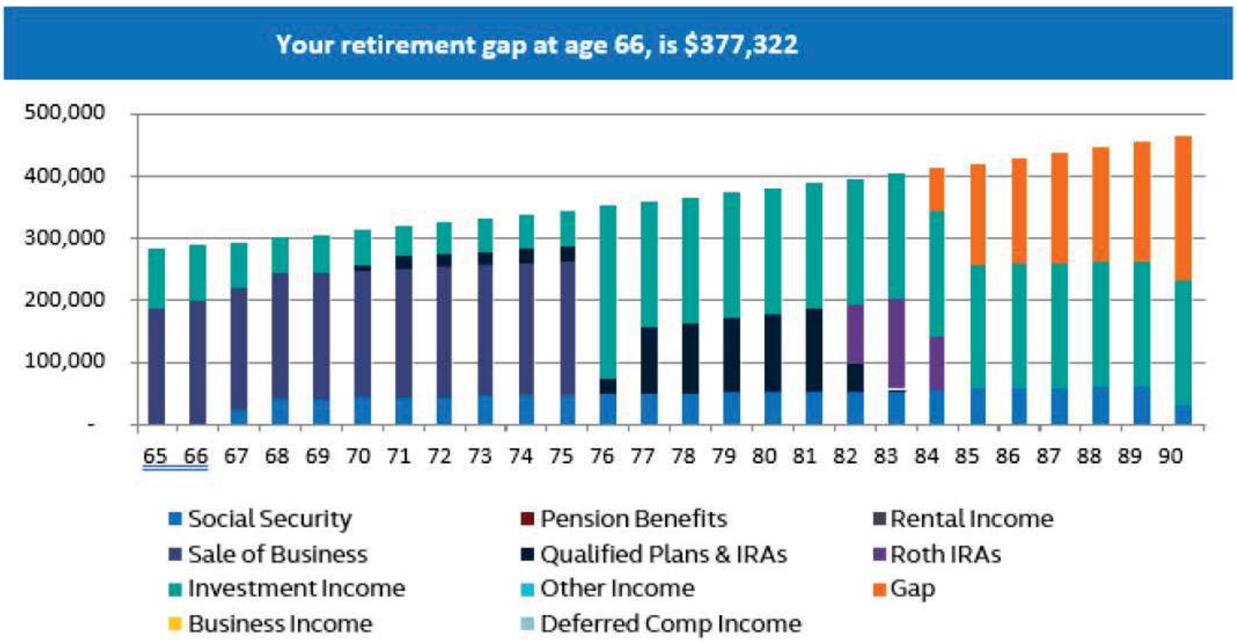
[1] If the requirements of IRC Section 101(j) are not met, then death proceeds from employer-owned life insurance contracts may be taxable as ordinary income in excess of the cost basis.

Your business plays a key role in your retirement

You've poured a lot of yourself into making your business successful. Now, it's time to take a few steps to make sure you're building a solid foundation for your retirement. Your business can play a key role.

Many financial professionals say that each of us will need annual income of at least 80% percent of our pre-retirement earnings to maintain our current standard of living during retirement. Where will that money come from? You may be relying on a combination of Social Security, a qualified retirement plan such as a 401(k) plan and your business. However, Social Security and qualified retirement plans can actually discriminate against business owners by placing limits on contributions, payouts and tax advantages. This can result in a retirement income gap.

Sample retirement gap calculation from Business Owner Retirement Analysis



Your business may be the key

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.

Many assume that the sale of their business will provide enough to keep them comfortable. But, some find out when it's time to sell that the business isn't worth enough to sustain their income needs. In order to know where you stand, you need to consider the potential sale price of your business. Then, you can plan accordingly. Our Business Owner Retirement Analysis can pull all of these factors together to help you evaluate your current plans and financial position. Request your free analysis today.

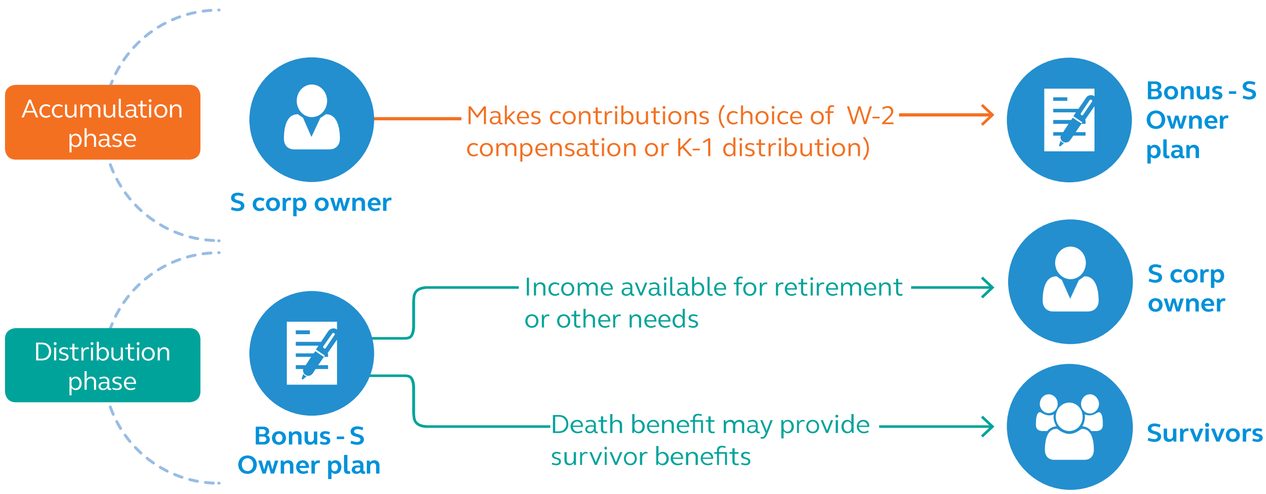
You may want to consider the following retirement solutions.

Principal® Bonus - S Owner

Where will you get your retirement income? Social Security? A 401(k)? For many business owners, even if you rely on both sources, it may not be enough. You may also be relying on a regular income stream, or proceeds from the sale of your business to fill this gap. Either strategy involves uncertainty. This bonus plan may be a more reliable way to address your retirement income goals. It offers death benefit protection and helps you save more for retirement. And it can provide tax leverage without contribution limits and restrictions on compensation. The tax leverage comes with using life insurance to finance the plan, rather than it being based on a tax code provision.

Here's how it works

You select an amount to contribute from W-2 compensation or K-1 distributions[1]—and your dollars are used to finance the personally owned asset—like life insurance. At retirement, you may access the values in the financial asset to help supplement your retirement income.



What you need to know

There are many advantages to this plan for you, just as there are some things to consider.

Save more – While qualified plans and Roth IRAs offer tax benefits, they have limits on compensation and contributions that don't apply to this bonus plan.[1]

Choose from contribution options – As an S corporation owner, you can choose to take income as W-2 compensation or a K-1 distribution, allowing some payroll tax leverage.

Pay out distributions properly – If there's more than one owner, and K-1 distributions are used, distributions need to be in proportion to ownership.

Pay income tax now – Whether profits are distributed or retained for business expansion, you and any other owners are taxed on the profits of the business.[2]

Need to be healthy – You must be able to qualify for life insurance if you choose to use it for financing the plan.

Choose alternate financing options – If you or another owner is unable to qualify for life insurance, other options for financing the plan are available. But these options will have different tax implications regarding accumulation and distribution.

[1] Contributions must meet reasonable compensation regulations.

[2] S corporation owners report their share of business profits on their personal tax returns. Depending on your type of business and other personal income, you might be entitled to a deduction of up to 20% of your passthrough income, as a result of a deduction added by the Tax Cuts and Jobs Act.

Protect your income and your business

Individual disability insurance protects your income and business against life's uncertainties so you can avoid dipping into savings or retirement assets if you're too sick or hurt to work.

Consider the **four key areas** that can be impacted by a disabling event.

Income protection/ benefit planning

How will you pay the bills if you become too sick or hurt to work? Do you offer employees group long-term disability (LTD) insurance? Do you offer special benefits to retain/reward your key employees?

Individual disability income insurance benefits:

- Helps replace a portion of your income lost due to a prolonged illness or injury.
- Helps maintain your lifestyle without draining savings or business profits.
- Provides a valuable employee benefit.

Retirement savings

Would you or your key employees still be able to save for retirement if you could no longer work due to a disability?

DI retirement security benefit:

- Helps you continue to save for retirement since often 401(k) (and employer match), Social Security and pension plan contributions stop if you can't work.

Business protection

How will you pay business loans and expenses if an owner becomes too sick or hurt to work? What will you do if a key employee can't work due to a disabling illness or injury?

Three solutions offer protection:

- **Overhead expense insurance –** Reimburses you for fixed business expenses.
- **Business loan protection[2] –** Provides payments to help cover the cost of a business-related loan obligation.
- **Key person replacement insurance[3] –** Provides benefits to the business in the event an insured key employee becomes totally disabled.

Business succession planning

If you have a buy-sell agreement, is it funded if an owner becomes disabled?

Disability buy-out insurance funds a buy-sell agreement if an owner becomes totally disabled. Benefits for you and your partners:

- Maximize the financial return when the business is transferred, while minimizing tax liability.
- Help the business survive a partner's departure, allowing remaining owner(s) and their family(ies) to receive the full value of the business.

[1] DI retirement security is issued as a non-cancelable, guaranteed renewable, individual disability income insurance policy. It is not a pension or retirement program or a substitute for such a program. DI retirement security is not available for government employees or anyone who is over insured based on Principal Life's current Issue and Participation guidelines. It may not be available or the benefit amount may be reduced for certain occupations if there is existing DI coverage with lifetime benefits. Additional underwriting guidelines may apply.

[2] Available as a rider on an overhead expense insurance policy. Not available in all states. Visit principal.com/distateapprovals to learn more.

[3] Benefits cannot be given to the key employee.

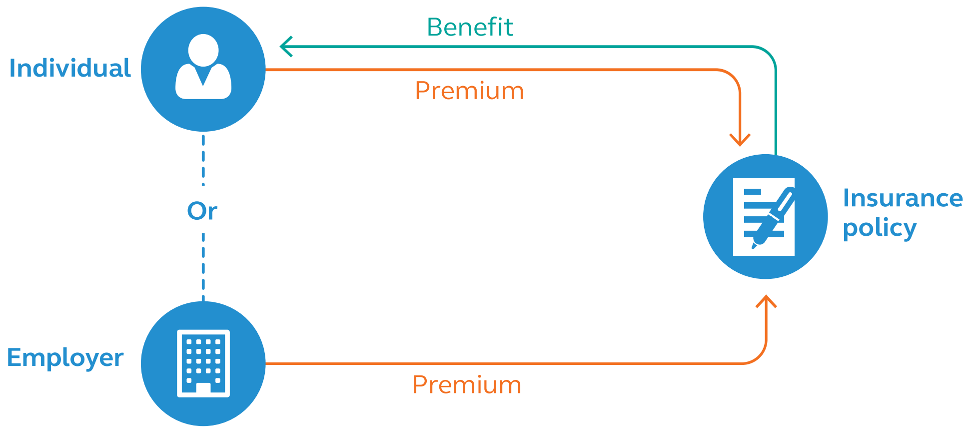
You may want to consider the following disability insurance solutions.

Individual disability income insurance

Protecting your income using individual disability income insurance is a smart move. It provides monthly benefit payments, like a "paycheck", if you're too sick or hurt to work.

Here's how it works

An individual or employer pays premium on an individual disability income policy. Upon meeting the definition of disability, the insured is paid a monthly benefit for a set period of time stated in the policy. Benefit amounts are calculated based on current income, occupation when the policy was purchased, medical history and if other disability insurance policies exist.



What you need to know

There are many advantages to this protection, just as there are some things to consider.

For your business:

Benefits enhancement – Can be an excellent addition to an employee benefit package if the employer pays all or part of the premium.

Tax efficiency – Premium can be paid with pre-tax dollars. But the benefits paid to the employee, if they're disabled, will be taxed.

Tool to recruit, retain and reward – Executive carve-out and bonus opportunities are available for key employees.

Available discounts – If three or more individuals with a common employer purchase coverage, then they're eligible for a 20% multi-life discount (based on unisex rates).

For the individual:

Increased protection – Can supplement group disability insurance coverage to protect more income.

Tax-free benefits – If premiums are paid with after-tax dollars, then the benefits received are tax free.

Portable benefits – If the individual leaves the employer, they can take the policy and discounts with them—as long as they continue to pay for the coverage.

Slight delay in benefits – Benefit payments begin one month after you satisfy the policy's elimination period (the number of days you must wait before benefits begin).

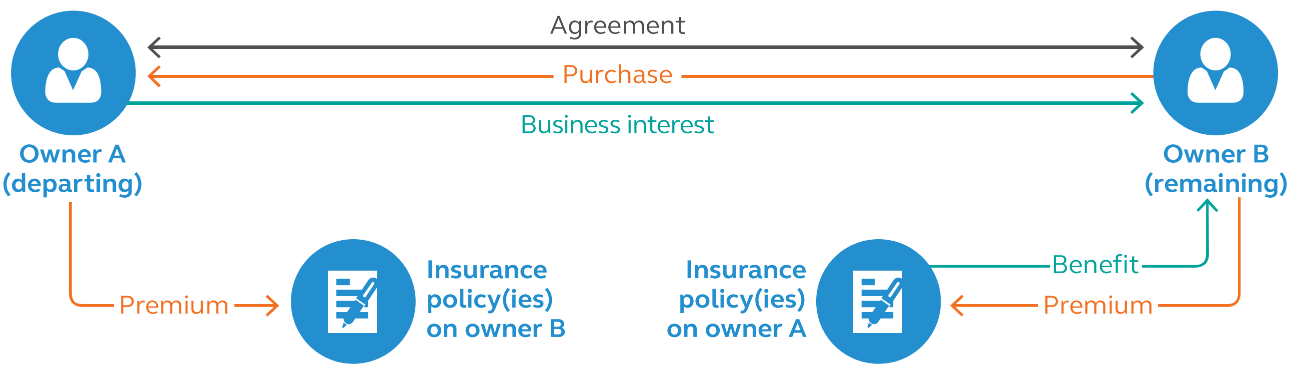
Disability buy-out insurance

Make sure your business is protected—no matter what life brings—with disability buy-out insurance. It helps provide the funding to purchase a disabled owner's interest in a business under a buy-sell agreement (such as cross purchase or entity purchase) in the event of a total disability. And, it lets remaining owner(s) continue to run the business without interruption.

Here's how it works

In a cross purchase buy-sell agreement (illustrated below) – Each owner purchases a disability insurance policy on each of the other owners. Each is the premium payer and beneficiary of the policies he or she owns. Upon a disability, the remaining owners purchase the disabled owner's interest.

In an entity purchase buy-sell agreement – The business is the owner, premium payer and beneficiary of a policy on each owner. Then the business purchases the disabled owner's interest upon a disability.



What you need to know

There are advantages to this sort of protection, just as there are some other things to consider.

Buy-sell agreement not required for insurance purchase – However, one must be in place at the time of a disability claim. (In New York, an agreement is required before purchasing a policy.)

Peace of mind – Knowing a funded exit plan is in place.

Potential taxes for the disabled owner – Pays taxes on the gain from the sale of the business. Any portion of the payout that's structured as non-compete or severance pay may be taxed differently. The gain may be considered an installment sale if at least one payment is received after the close of the tax year in which the sale was made.

Tax benefits for remaining owner(s) – Even though insurance premiums aren't deductible, the benefits are received income tax-free. And, the payout can be structured as a non-compete or severance pay, which is generally tax deductible.

Minimized taxes upon a subsequent sale – Remaining owner(s) receive an increased cost basis as a result of the purchase price paid to the departing owner.

Key person replacement insurance

Make sure your business is protected—no matter what life brings—with key person replacement insurance. It pays benefits to your business if a key person (or you, the owner) becomes totally disabled. The remaining owner(s) can use the benefits as they wish—to cover recruitment costs, pay for temporary staffing, replace revenue or deal with other business needs.[1]

Here's how it works

Your business is the owner and beneficiary of a disability insurance policy for each key employee chosen, which can include owners. If a total disability occurs, the business receives cash, generally income tax-free, to help handle the loss.

What you need to know

There are advantages to this sort of protection, just as there are some other things to consider.

Tax-free benefits – The business generally doesn't pay income taxes on the benefits received.

Financial stability – You don't have to worry about how you will pay for the loss and replacement of a key employee and the policy can demonstrate financial stability to creditors and clients.

Business owns the policy – Benefits can't be assigned to the employee and are paid only to the business.

[1] The benefit payments cannot be given to the disabled key employee or owner.

Plan services that make things easier for you

It takes a lot of work to run a company, to say the least. And, we understand you may not have time to think about business transfer strategies, employee retention programs, or retirement planning. That's okay. That's why we're here.

How do you get started?

Together with your financial professional, Principal will help you identify the right solutions for your organization, then work with you to implement them properly. Staffed with attorneys, CPAs, and plan design specialists, our Business and Advanced Solutions team is ready to assist you with design consultation and sample plan documents. But, we don't stop there.

Your needs may change. Regulations may change. We can help you keep up with both.

You don't have to take care of the ongoing management of your plan all by yourself. Our Business Market Administration team provides dedicated, ongoing support for your employer-owned and employer-sponsored plans funded with life insurance. And we'll be there not just today, but throughout the life of your plan.

Administrative services

Plan-level consulting – Reviews your specific needs, then helps you design, implement and administer an effective plan.

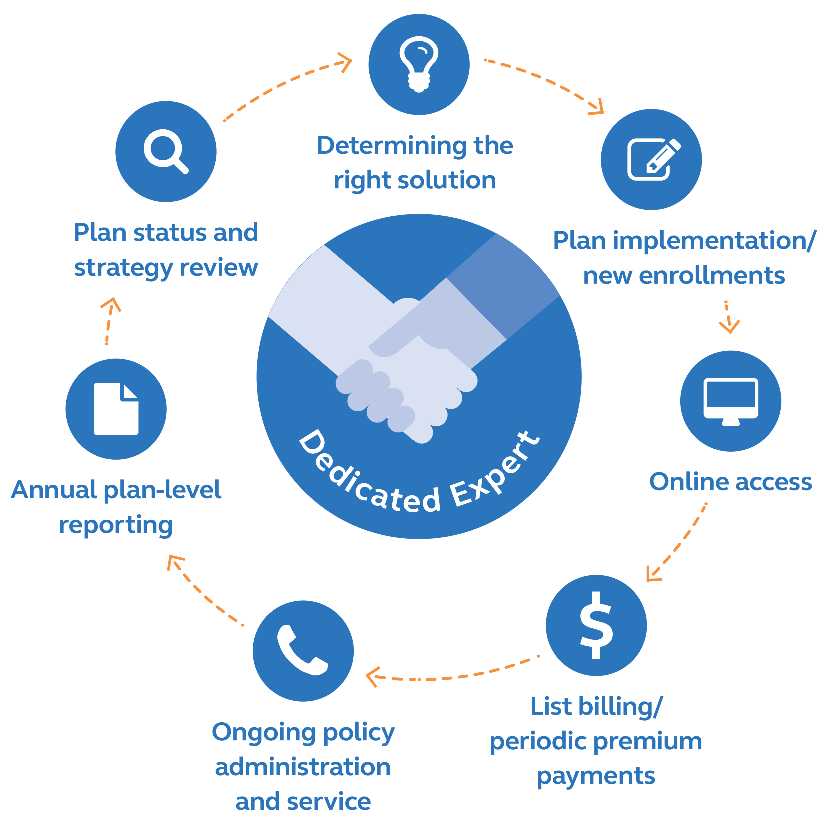
Dedicated administrator – Personally assists you with enrollments, policy adjustments, service requests, policy illustrations, and more.

Plan-level reporting – Makes participant communications and any needed tax reporting easier. Consolidated reports show current coverage amounts, policy values, and premium information for all participants with life policies under your plan.

List billing – Delivers consolidated payment reminders covering all policies under your plan—billed annually, semiannually, quarterly or monthly.

Online access – Allows you to view policy information 24/7. Policy owners may also make changes or initiate service requests.

Supporting you every step of the way



Your customized planning considerations

We're here to help you achieve your goals. We understand that some of your goals are more important to you than others. So, make sure to let us know which items are priorities so we can focus our attention and your resources there first.

Business succession planning	Priority ranking	Target date
Business succession planning – In order to help you successfully transition out of your business, numerous buy-sell and transfer strategies are available. Principal can consult with you to identify a solution best suited to your unique needs and company characteristics.		
Family business succession planning – Exiting a family business often means balancing competing needs of your family members. Principal can look at your specific situation and present you with a personalized planning report that includes planning considerations and action steps unique to your business and family.		
Buy-sell agreement – Businesses with two or more owners need a buy-sell agreement fully funded with life and disability insurance. If one already is in place, a buy-sell review could be conducted by Principal. You may have or want to consider the following: › A cross purchase buy-sell agreement		
Select buy-out plan – If you have a key employee to pass the business to or who can buy the business, you may want to consider a one way buy-sell arrangement along with a select buy-out plan. This will help the key employee save for a down payment on the business buy-in.		
Buy-sell agreement funding – A properly funded and well-drafted agreement that reflects your goals and objectives can protect you during both planned and unplanned events. Do you have adequate funding in place?		
Business and key employee protection		
Key person life insurance – It's likely that your business relies heavily upon the talents of your key employees. Consider purchasing life insurance policies on all owners and those key employees integral to the success of your business. Principal offers a key person calculator to help you and your financial professional determine the appropriate amount of coverage.		

	Priority ranking	Target date
Recruit, reward, retain, retire key employees – Consider the following to help fulfill a valuable benefit for select key employees that can also help you recruit, reward, retain and retire those who are vital to the success of your business. › A Principal® Bonus plan › A Principal® Deferred Comp – Select Reward plan		
Business owner retirement planning		
Business Owner Retirement Analysis – This personalized report can help you evaluate whether you have the right plans in place to figure out how much you can rely on your business for retirement income. It can identify any gaps and if needed, direct you to strategies to help you achieve retirement readiness.		
Principal® Bonus – S Owner – As a profitable S corporation, this nonqualified retirement plan could complement other retirement plans you currently have in place.		
Disability insurance		
Individual disability income insurance – Consider purchasing disability income insurance to protect your income should you become too sick or hurt to work.		
Disability buy-out insurance – Consider protecting the value of your business by using this to fund a buy-sell agreement that would enable you to buy out a totally disabled business owner.		
Key person replacement insurance – Consider how your business might suffer in the event a disabling illness or injury kept a key employee from working. From managers to administrative assistants or other integral individuals, there could be a significant negative impact on sales, customer relationships and/or creditors.		

No one knows your business and your specific needs as well as you do. By working closely with your financial professional, you'll be able to formulate a plan that works for you. Whether it's analysis of your current plans, assistance with future plans, insurance protection or all three, Principal is here to help.

You benefit from a partner who 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[1]
- Provider of nonqualified executive benefit plan administrative services for more than 4,700 employers, representing 75,000 plan participants.[2]
- Preparer of thousands of informal business valuations since 2011.
- Reviewer of more than 1,800 buy-sell agreements since 2011.

[1] Based on total number of Section 409A plans, PLANSPONSOR 2018 Record-Keeping Survey, June 2018.
[2] As of June 30, 2018.

principal.com

The previous pages depict certain business planning options. All of these options are based on the information you shared with us for this purpose and the assumptions stated throughout the report. Of course, any variance in the information or assumptions could change the results.

All assets assume specific growth rates, calculated based on information from the client. These individual rates are used to project the possible growth of the business. These projections are made to estimate future business insurance needs.

Although the informal business valuation from The Principal can provide a valuable starting point in helping you determine the value of your business, the valuation will not be a substitute for a formal valuation nor does it establish a value for tax purposes. A formal valuation should be constructed with the guidance of your legal and/or tax advisors.

Solutions outlined in this report do not imply a recommendation that a specific business planning option should be implemented. Rather it represents a summary of potential considered strategies, which each individual should discuss with his or her tax advisor, attorney, and/or other professional advisor before taking any action.

Because your business planning goals may change in the future, periodic monitoring should be an essential component of your program.

All guarantees and benefits of the insurance policy are backed by the claims-paying ability of the issuing insurance company. They are not backed by the broker/dealer and/or insurance agency selling the policy, nor by any of their affiliates, and none of them makes any representations or guarantees regarding the claims-paying ability of the issuing insurance company.

Disability income insurance has certain limitations and exclusions. For costs and complete coverage details, contact your Principal representative.

Individual disability insurance Series 700. Not all products available in all states.

The subject matter in this communication is provided with the understanding that Principal® is not rendering legal, accounting, or tax advice. You should consult with appropriate counsel or other advisors on all matters pertaining to legal, tax, or accounting obligations and requirements.

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