



## FUNDING THE BUY-SELL

# Methods of Funding the Buy-Out

**Cash Sinking Fund:** Cash is simple and straight forward, except that very few businesses will have adequate cash on hand to fund the buy-out of a significant shareholder. Even if ample cash was available, depleting these funds would likely hamstring the business operating capital and cause other impairments to the business entity. Even if the business starts putting away significant sums every year, there will rarely be enough funds to cover an early buy-out at an uncertain moment in time.

**Borrowing:** Borrowing adequate funds will still be an uncertain cost as no one knows when a death may occur and what the loan terms available may be at that given time. If the deceased shareholder was part of active management, how will this impact the credit-worthiness of the business seeking a large loan? How will the cash flow demands of repaying the loan impact the operation of the business? How much will the total loan cost?

**Installment Payments:** An installment sale merely delays the obligation and masks the full extent of the problem. It does not provide cash to effect the buy-out. Both the buyer and the seller are totally dependent upon the wherewithal of the business to provide the cash flows necessary to finance the buy-out. The seller's estate and family must be patient and they are only secured by the assumed future profitability of the business. The seller's estate must have adequate funding elsewhere to pay for estate taxes and estate settlement costs which could be sizeable for a wealthy shareholder.

**Life Insurance:** Life insurance provides an immediate and certain sum of money at the unpredictable moment in time when it is needed the most. Premium payments for permanent life insurance may be viewed as advance installment payments and as a cash sinking fund, but the unique virtues of life insurance make it the optimum funding source for buy-out planning. Unlike a cash sinking fund, an early death is covered by the death proceeds. A cash sinking will always be left behind. Spreading out the premium payments over many years may be seen as a type of installment sale, but premium payments will always be less than the principal sum (death benefit). An installment sale or borrowing will always cost more than the principal sum when you add the interest costs to the equation. Additionally, the cash value growth of a life insurance policy will be an asset of the company and it will offset the effect on earnings each year.



## FUNDING THE BUY-SELL

# Chance of Death – Life Expectancy

		Chance of Death By Duration of Years				
Gender/Age	Years to Life Expectancy	10 Years	15 Years	20 Years	25 Years	
Male Age 64	23	23.3%	41.1%	61.5%	80.6%	
Female Age 62	30	12.5%	22.6%	36.4%	53.8%	
Male Age 60	30	17.0%	30.6%	48.1%	67.6%	
Male Age 59	31	15.8%	28.4%	45.0%	64.1%	
Male Age 56	33	12.5%	22.6%	36.4%	53.8%	
Chance of at least 1 death		NA	59.0%	82.4%	95.6%	99.5%

Life Expectancies based upon 2008 VBT Mortality and M Financial improved Experience

\*Life Expectancy based upon Standard 2008 VBT Mortality Table

Chance of death and chance of at least 1 death based upon 1980 CSO Mortality Table



## FUNDING THE BUY-SELL

# Net Present Value Comparison

Compares Cost of Different Buy-Out Funding Methods  
Funding \$20M for 4 Shareholders (\$80M Total)

Method of Funding Buy-Out	Net Present Value Cost
Cash Sinking Fund	33,719,465
Borrowing	61,078,265
Installment Payments	62,179,608
Life Insurance	17,617,954
Life Insurance Adjusted for deaths	14,465,432

NOT VALID WITHOUT COMPLETE LIFE INSURANCE ILLUSTRATIONS SHOWING IMPORTANT INFORMATION ABOUT GUARANTEED AND NON-GUARANTEED VALUES.  
EACH UNIVERSAL LIFE ILLUSTRATIONS IS DESIGNED TO BE LEVEL FUNDED BASED UPON CURRENT INTEREST RATES WITH A DURATION OF COVERAGE TO AGE 95.



## FUNDING THE BUY-SELL

# Assumptions for Comparisons

- Given that there is an 82.4% chance of a first death by year 15, we will assume a first death at this point in time. Thereafter, we will stagger the assumed deaths at years 20, 25, and 30.
- These comparisons address the funding of the 4 shareholders we have underwritten for insurance even though we included a non-underwritten partner in the preceding life expectancy composite analysis.
- Each method analyzed (Cash Sinking Fund, Borrowing, and Installment Payments) reflects a (1) single buy-out of \$20M at year 15 and (2) a composite buy-out for each shareholder in years 15, 20, 25, and 30.
- The life insurance comparison reflects our recommended solution showing (1) funding for all 4 shareholders for 30 years, and (2) an adjusted funding scenario assuming an aggregate adjustment for hypothetical deaths in years 15, 20, 25, and 30 (*note that there are several types of product and funding variations available*)
- **Cash Sinking Fund** – Assumes a starting balance of \$1M and shows the required funding level starting immediately at a 4% net rate of return.
- **Borrowing** – Assumes borrowing at each interval with a 10 year amortization at 5% loan interest rate.
- **Installment Payments** – Assumes a \$5M down payment to each decedent followed by a 10 year payment plan assuming a 4% interest rate.
- **Life Insurance** – Our recommended permanent life insurance approach uses a current assumption universal life product for each insured. Further details are contained in our underwriting/product design presentation.

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## FUNDING THE BUY-SELL

# Cash Sinking Fund

### FUNDING A SINGLE BUY-OUT

Yr	BOY Sinking Fund	After-Tax Annual Funding	Buy-Out Event	4% Net Earnings	EOY Sinking Fund
1	1,000,000	920,000	-	76,800	1,996,800
2	1,996,800	920,000	-	116,672	3,033,472
3	3,033,472	920,000	-	158,139	4,111,611
4	4,111,611	920,000	-	201,264	5,232,875
5	5,232,875	920,000	-	246,115	6,398,990
6	6,398,990	920,000	-	292,760	7,611,750
7	7,611,750	920,000	-	341,270	8,873,020
8	8,873,020	920,000	-	391,721	10,184,741
9	10,184,741	920,000	-	444,190	11,548,930
10	11,548,930	920,000	-	498,757	12,967,688
11	12,967,688	920,000	-	555,508	14,443,195
12	14,443,195	920,000	-	614,528	15,977,723
13	15,977,723	920,000	-	675,909	17,573,632
14	17,573,632	920,000	-	739,745	19,233,377
15	19,233,377	920,000	(20,000,000)	6,135	159,512
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### FUNDING 4 SHAREHOLDER BUY-OUTS

Yr	BOY Sinking Fund	After-Tax Annual Funding	Buy-Out Event	4% Net Earnings	EOY Sinking Fund
1	1,000,000	1,950,000	-	118,000	3,068,000
2	3,068,000	1,950,000	-	200,720	5,218,720
3	5,218,720	1,950,000	-	286,749	7,455,469
4	7,455,469	1,950,000	-	376,219	9,781,688
5	9,781,688	1,950,000	-	469,268	12,200,955
6	12,200,955	1,950,000	-	566,038	14,716,993
7	14,716,993	1,950,000	-	666,680	17,333,673
8	17,333,673	1,950,000	-	771,347	20,055,020
9	20,055,020	1,950,000	-	880,201	22,885,221
10	22,885,221	1,950,000	-	993,409	25,828,630
11	25,828,630	1,950,000	-	1,111,145	28,889,775
12	28,889,775	1,950,000	-	1,233,591	32,073,366
13	32,073,366	1,950,000	-	1,360,935	35,384,300
14	35,384,300	1,950,000	-	1,493,372	38,827,672
15	38,827,672	1,950,000	(20,000,000)	831,107	21,608,779
16	21,608,779	1,950,000	-	942,351	24,501,130
17	24,501,130	1,950,000	-	1,058,045	27,509,176
18	27,509,176	1,950,000	-	1,178,367	30,637,543
19	30,637,543	1,950,000	-	1,303,502	33,891,044
20	33,891,044	1,950,000	(20,000,000)	633,642	16,474,686
21	16,474,686	1,950,000	-	736,987	19,161,674
22	19,161,674	1,950,000	-	844,467	21,956,141
23	21,956,141	1,950,000	-	956,246	24,862,386
24	24,862,386	1,950,000	-	1,072,495	27,884,882
25	27,884,882	1,950,000	(20,000,000)	393,395	10,228,277
26	10,228,277	1,950,000	-	487,131	12,665,408
27	12,665,408	1,950,000	-	584,616	15,200,024
28	15,200,024	1,950,000	-	686,001	17,836,025
29	17,836,025	1,950,000	-	791,441	20,577,466
30	20,577,466	1,950,000	(20,000,000)	101,099	2,628,565



# FUNDING THE BUY-SELL

# Borrowing

## FUNDING A SINGLE BUY-OUT

Yr	Buy-Out	BOY Note Payable	Principal Payment	5% Interest Payment	BOY Amortization Schedule	EOY Principal Balance
1						
2						
3						
4						
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15	20,000,000	20,000,000	1,466,754	1,000,000	2,466,754	18,533,246
16		18,533,246	1,540,091	926,662	2,466,754	16,993,155
17		16,993,155	1,617,096	849,658	2,466,754	15,376,059
18		15,376,059	1,697,951	768,803	2,466,754	13,678,108
19		13,678,108	1,782,848	683,905	2,466,754	11,895,259
20		11,895,259	1,871,991	594,763	2,466,754	10,023,268
21		10,023,268	1,965,590	501,163	2,466,754	8,057,678
22		8,057,678	2,063,870	402,884	2,466,754	5,993,808
23		5,993,808	2,167,063	299,690	2,466,754	3,826,745
24		3,826,745	2,275,417	191,337	2,466,754	1,551,328
25						-
26						
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## FUNDING 4 SHAREHOLDER BUY-OUTS

Yr	Buy-Out	BOY Notes Payable	Principal Payment	5% Interest Payment	BOY Amortization Schedule	EOY Principal Balance
1						
2						
3						
4						
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11						
12						
13						
14						
15	20,000,000	20,000,000	1,466,754	1,000,000	2,466,754	18,533,246
16		18,533,246	1,540,091	926,662	2,466,754	16,993,155
17		16,993,155	1,617,096	849,658	2,466,754	15,376,059
18		15,376,059	1,697,951	768,803	2,466,754	13,678,108
19		13,678,108	1,782,848	683,905	2,466,754	11,895,259
20	20,000,000	31,895,259	3,338,745	1,594,763	4,933,508	28,556,515
21		28,556,515	3,505,682	1,427,826	4,933,508	25,050,833
22		25,050,833	3,680,966	1,252,542	4,933,508	21,369,867
23		21,369,867	3,865,014	1,068,493	4,933,508	17,504,853
24		17,504,853	4,058,265	875,243	4,933,508	13,446,588
25	20,000,000	31,895,259	3,338,745	1,594,763	4,933,508	28,556,515
26		28,556,515	3,505,682	1,427,826	4,933,508	25,050,833
27		25,050,833	3,680,966	1,252,542	4,933,508	21,369,867
28		21,369,867	3,865,014	1,068,493	4,933,508	17,504,853
29		17,504,853	4,058,265	875,243	4,933,508	13,446,588
30	20,000,000	31,895,259	3,338,745	1,594,763	4,933,508	28,556,515
31		28,556,515	3,505,682	1,427,826	4,933,508	25,050,833
32		25,050,833	3,680,966	1,252,542	4,933,508	21,369,867
33		21,369,867	3,865,014	1,068,493	4,933,508	17,504,853
34		17,504,853	4,058,265	875,243	4,933,508	13,446,588
35		11,895,259	1,871,991	594,763	2,466,754	10,023,268
36		10,023,268	1,965,590	501,163	2,466,754	8,057,678
37		8,057,678	2,063,870	402,884	2,466,754	5,993,808
38		5,993,808	2,167,063	299,690	2,466,754	3,826,745
39		3,826,745	2,275,417	191,337	2,466,754	1,551,328



## FUNDING THE BUY-SELL

# Installment Payments

### FUNDING A SINGLE BUY-OUT

Yr	Buy-Out	Down Payment	BOY Note Payable	Principal Payment	4% Interest Payment	BOY Amortization Schedule	EOY Principal Balance
1							
2							
3							
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7							
8							
9							
10							
11							
12							
13							
14							
15	20,000,000	5,000,000	15,000,000	1,178,235	600,000	1,778,235	13,821,765
16			13,821,765	1,225,364	552,871	1,778,235	12,596,401
17			12,596,401	1,274,379	503,856	1,778,235	11,322,022
18			11,322,022	1,325,354	452,881	1,778,235	9,996,668
19			9,996,668	1,378,368	399,867	1,778,235	8,618,300
20			8,618,300	1,433,503	344,732	1,778,235	7,184,798
21			7,184,798	1,490,843	287,392	1,778,235	5,693,955
22			5,693,955	1,550,477	227,758	1,778,235	4,143,478
23			4,143,478	1,612,496	165,739	1,778,235	2,530,983
24			2,530,983	1,676,995	101,239	1,778,235	853,987
25							-
26							
27							
28							
29							
30							

### FUNDING 4 SHAREHOLDER BUY-OUTS

Yr	Buy-Out	Down Payment	BOY Notes Payable	Principal Payment	4% Interest Payment	Amortization Schedule	EOY Principal Balance
1							
2							
3							
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10							
11							
12							
13							
14							
15	20,000,000	5,000,000	15,000,000	1,178,235	600,000	1,778,235	13,821,765
16			13,821,765	1,225,364	552,871	1,778,235	12,596,401
17			12,596,401	1,274,379	503,856	1,778,235	11,322,022
18			11,322,022	1,325,354	452,881	1,778,235	9,996,668
19			9,996,668	1,378,368	399,867	1,778,235	8,618,300
20	20,000,000	5,000,000	23,618,300	2,611,738	944,732	3,556,470	21,006,563
21			21,006,563	2,716,207	840,263	3,556,470	18,290,356
22			18,290,356	2,824,855	731,614	3,556,470	15,465,501
23			15,465,501	2,937,850	618,620	3,556,470	12,527,651
24			12,527,651	3,055,364	501,106	3,556,470	9,472,288
25	20,000,000	5,000,000	23,618,300	2,611,738	944,732	3,556,470	21,006,563
26			21,006,563	2,716,207	840,263	3,556,470	18,290,356
27			18,290,356	2,824,855	731,614	3,556,470	15,465,501
28			15,465,501	2,937,850	618,620	3,556,470	12,527,651
29			12,527,651	3,055,364	501,106	3,556,470	9,472,288
30	20,000,000	5,000,000	23,618,300	2,611,738	944,732	3,556,470	21,006,563
31			21,006,563	2,716,207	840,263	3,556,470	18,290,356
32			18,290,356	2,824,855	731,614	3,556,470	15,465,501
33			15,465,501	2,937,850	618,620	3,556,470	12,527,651
34			12,527,651	3,055,364	501,106	3,556,470	9,472,288
35			8,618,300	1,433,503	344,732	1,778,235	7,184,798
36			7,184,798	1,490,843	287,392	1,778,235	5,693,955
37			5,693,955	1,550,477	227,758	1,778,235	4,143,478
38			4,143,478	1,612,496	165,739	1,778,235	2,530,983
39			2,530,983	1,676,995	101,239	1,778,235	853,987



## FUNDING THE BUY-SELL

# Life Insurance

### FUNDING 4 SHAREHOLDERS EVERY YEAR

Yr	Annual Premium	Cash Values	Cash Value Increase	Annual Effect on Earnings	Cumulative Effect on Earnings	Death Benefits
1	1,018,848	496,254	496,254	522,594	522,594	80,000,000
2	1,018,848	1,046,574	550,320	468,528	991,122	80,000,000
3	1,018,848	1,596,496	549,922	468,926	1,460,048	80,000,000
4	1,018,848	2,146,649	550,153	468,695	1,928,743	80,000,000
5	1,018,848	2,696,132	549,483	469,365	2,398,108	80,000,000
6	1,018,848	3,242,709	546,577	472,271	2,870,379	80,000,000
7	1,018,848	3,775,834	533,125	485,723	3,356,102	80,000,000
8	1,018,848	4,285,394	509,560	509,288	3,865,390	80,000,000
9	1,018,848	4,775,195	489,802	529,046	4,394,437	80,000,000
10	1,018,848	5,240,408	465,213	553,635	4,948,072	80,000,000
11	1,018,848	5,952,919	712,510	306,338	5,254,409	80,000,000
12	1,018,848	6,654,008	701,090	317,758	5,572,168	80,000,000
13	1,018,848	7,344,190	690,181	328,667	5,900,834	80,000,000
14	1,018,848	8,007,970	663,780	355,068	6,255,902	80,000,000
15	1,018,848	8,629,801	621,831	397,017	6,652,919	80,000,000
16	1,018,848	9,221,004	591,202	427,646	7,080,564	80,000,000
17	1,018,848	9,798,689	577,686	441,162	7,521,727	80,000,000
18	1,018,848	10,334,013	535,323	483,525	8,005,251	80,000,000
19	1,018,848	10,835,020	501,007	517,841	8,523,092	80,000,000
20	1,018,848	11,282,536	447,516	571,332	9,094,424	80,000,000
21	1,018,848	11,589,591	307,055	711,793	9,806,217	80,000,000
22	1,018,848	11,808,927	219,337	799,511	10,605,729	80,000,000
23	1,018,848	11,935,095	126,167	892,681	11,498,409	80,000,000
24	1,018,848	11,952,266	17,171	1,001,677	12,500,086	80,000,000
25	1,018,848	11,821,097	(131,169)	1,150,017	13,650,103	80,000,000
26	1,018,848	11,738,050	(83,048)	1,101,896	14,751,998	80,000,000
27	1,018,848	11,523,295	(214,755)	1,233,603	15,985,601	80,000,000
28	1,018,848	11,149,416	(373,879)	1,392,727	17,378,328	80,000,000
29	1,018,848	10,600,103	(549,312)	1,568,160	18,946,489	80,000,000
30	1,018,848	9,903,316	(696,787)	1,715,635	20,662,124	80,000,000

### ADJUSTED FUNDING FOR ASSUMED DEATHS

Yr	Annual Premium	Cash Values	Cash Value Increase	Annual Effect on Earnings	Cumulative Effect on Earnings	Death Benefits
1	1,018,848	496,254	496,254	522,594	522,594	80,000,000
2	1,018,848	1,046,574	550,320	468,528	991,122	80,000,000
3	1,018,848	1,596,496	549,922	468,926	1,460,048	80,000,000
4	1,018,848	2,146,649	550,153	468,695	1,928,743	80,000,000
5	1,018,848	2,696,132	549,483	469,365	2,398,108	80,000,000
6	1,018,848	3,242,709	546,577	472,271	2,870,379	80,000,000
7	1,018,848	3,775,834	533,125	485,723	3,356,102	80,000,000
8	1,018,848	4,285,394	509,560	509,288	3,865,390	80,000,000
9	1,018,848	4,775,195	489,802	529,046	4,394,437	80,000,000
10	1,018,848	5,240,408	465,213	553,635	4,948,072	80,000,000
11	1,018,848	5,952,919	712,510	306,338	5,254,409	80,000,000
12	1,018,848	6,654,008	701,090	317,758	5,572,168	80,000,000
13	1,018,848	7,344,190	690,181	328,667	5,900,834	80,000,000
14	1,018,848	8,007,970	663,780	355,068	6,255,902	80,000,000
15	1,018,848	8,629,801	621,831	397,017	6,652,919	80,000,000
16	764,136	6,915,753	443,402	320,734	6,973,653	60,000,000
17	764,136	7,349,017	433,264	330,872	7,304,525	60,000,000
18	764,136	7,750,510	401,493	362,643	7,667,168	60,000,000
19	764,136	8,126,265	375,755	388,381	8,055,549	60,000,000
20	509,424	5,641,268	229,176	280,248	8,335,797	40,000,000
21	509,424	5,794,795	153,527	355,897	8,691,694	40,000,000
22	509,424	5,904,464	109,668	399,756	9,091,449	40,000,000
23	509,424	5,967,547	63,084	446,340	9,537,790	40,000,000
24	509,424	5,976,133	8,586	500,838	10,038,628	40,000,000
25	254,712	2,955,274	(32,792)	287,504	10,326,132	20,000,000
26	254,712	2,934,512	(20,762)	275,474	10,601,606	20,000,000
27	254,712	2,880,824	(53,689)	308,401	10,910,007	20,000,000
28	254,712	2,787,354	(93,470)	348,182	11,258,189	20,000,000
29	254,712	2,650,026	(137,328)	392,040	11,650,229	20,000,000
30	254,712	2,475,829	(174,197)	428,909	12,079,138	20,000,000

NOT VALID WITHOUT COMPLETE LIFE INSURANCE ILLUSTRATIONS SHOWING IMPORTANT INFORMATION ABOUT GUARANTEED AND NON-GUARANTEED VALUES. EACH UNIVERSAL LIFE ILLUSTRATIONS IS DESIGNED TO BE LEVEL FUNDED BASED UPON CURRENT INTEREST RATES WITH A DURATION OF COVERAGE TO AGE 95.





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# Disclosures

**This is a hypothetical example for illustrative purposes only. The example provided is not representative of all clients' experiences and are not indicative of any future performance or results.**

**Illustrated life insurance pricing is based on assumptions. To continue coverage beyond stated durations may require substantially higher premiums. Illustrated products and options shown based on product availability and pricing as of this date. Any product guarantees, including the death benefit, are subject to the claims paying ability of the issuing insurance company. This presentation is not complete without the accompanying illustrations.**

**This information has been taken from sources, which we believe to be reliable, but there is no guarantee as to its accuracy. This material is intended for informational purposes only and should not be construed as legal or tax advice and is not intended to replace the advice of a qualified attorney, tax advisor or plan provider.**

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