



Key Person: What you need to know and who you need to protect

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19 September 2019

Outline

- Corporate business structures
- Key persons
- Shareholder and Partnership Agreements
- Valuation of business interests
- Cross Option / Insured Share Buy Back Option Agreements
- Introduction to Tilney
- Key person & shareholder protection
- Cash flow on business exit
- Q & A

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HM Harper
Macleod LLP

Corporate business structures

- Sole trader
- **Partnership**
- Limited Partnership
- Limited Liability Partnership
- **Private company limited by shares**
- Private company limited by guarantee
- Public limited companies
- Unlimited companies

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Key persons

- Understand their motivators
- Clear goals / purpose
- Team support
- Development paths
- Feedback
- Money – salary, bonus scheme, profit share?
- Status – shareholding (non-voting?), partnership share, share options?
- Succession planning
- Protect business by locking them in – contract, restrictive covenant, status and ensure protection of intellectual property
- Protect business by having a clear exit route / insurance in place

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Shareholders' Agreement

- Right to appoint director / participate at board level
- Dividend rights
- Transfers of shares
- Voluntary offer round (including option for share buy back?)
- Deemed transfers
- Permitted transfers – ensure that there is a clawback mechanism
- Good Leaver / Bad Leaver
- Restrictive covenants
- Confidentiality

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Partnership Agreement

- Share of capital / profits
- Treatment of profits and losses
- Partner absence
- Managing Partner / Management Committee
- Meetings and decision making
- Retirement / expulsion
- Restrictive covenants
- Confidentiality
- Preservation of Partnership notwithstanding the admission / retirement / expulsion of partners

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Valuation of business interests

- Valuation of assets / Valuation of earnings
- Fair value / market value / fair market value / book value
- Parameters
- Willing buyer / willing seller
- Arms length terms
- Date of valuation
- Majority premium?
- Minority discount?
- Good Leaver / Bad Leaver
- Other valuation factors that need included
- Dispute and determination by independent accountant

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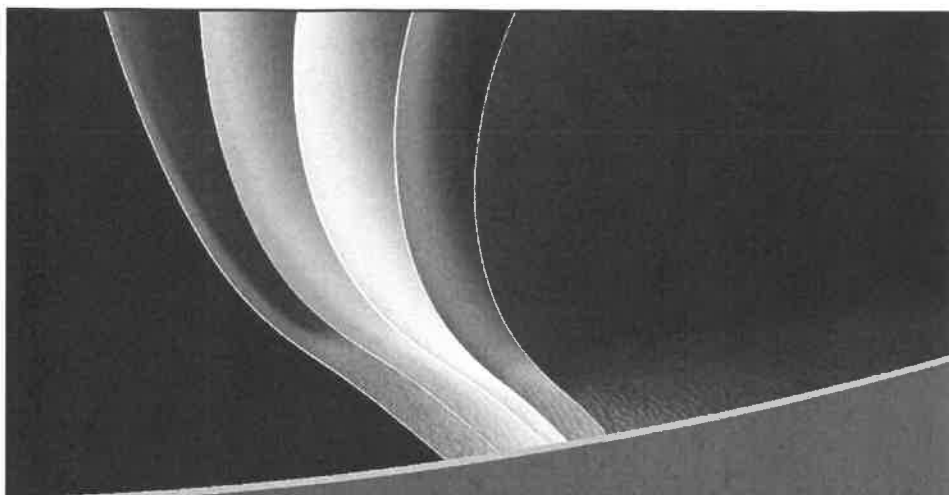


Cross Option / Insured Share Buy Back Option Agreements

- Cross Option – each party grants option in favour of other
- Insured Share Buy Back Option – shareholder / company each grant option in favour of the other
- Option period
- Exercise of options
- Consideration – sum covered in policy
- Obligations on policies / Trust / replacement of policies
- Need to ensure governing documents permit / consent / allow for transactions under option agreement(s) to take place
- Insured Share Buy Back Option – at least £1 of distributable profit in the company required for it to be effective


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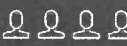





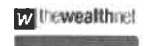



Key Person:
 What you need to know and who you need to protect
 DAVID VALLANCE
 12.09.2018

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A bit about us

| | | | | |
|---|--|--|---|---|
| <p>1</p> <p>of the UK's leading financial planning & investment management firms</p> | <p>180 years</p> <p>of helping clients achieve their financial goals</p> |  <p>100,000+</p> <p>clients trust us with their financial future</p> | <p>£24bn</p> <p>Assets under management</p> | <p>local offices across the</p> <p>UK</p> |
|  <p>1,200</p> <p>members of staff</p> |  <p>220</p> <p>Qualified Financial Planners</p> |  <p>120</p> <p>years of experience</p> | <p>14</p>  <p>dedicated research analysts, with an average of 10 years' industry experience</p> |  <p>10+ YEARS*</p> <p>performance track record</p> |
|  <p>Investment and Wealth Management Awards 2018 Winner</p> <p>Wealth Manager of the Year Tilney</p> |  <p>Top Financial Planning Companies 2018</p> | <p>Women in Financial Advice Awards 2018</p>   |  <p>Best Conventional Advisory Service Tilney</p> | |

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Services for business clients:

- Business Protection** We employ a full-time Technical Team to fully research this area and can advise on Shareholder/Partnership Protection, Key Person, Relevant Life and Loan Protection
- Extracting profits tax efficiently** By utilising various allowances including pensions.
- Tax Advantaged Investment** EIS, VCT, BR, AIM Specialists. We employ a dedicated Technical Team to research this area.
- Cash flow in advance of exit** Planning for OMB and corporate clients on business exit strategy.
- Range of Investment Management Options** Discretionary, Advisory and Execution-Only options. Ability to build bespoke, diversified portfolios and utilise direct equity
- Cash deposit service** To help clients gain a better rate of interest on balances while maximising Financial Services Compensation Scheme Protection.

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Insured solutions to protect a business

Continuity and succession planning for business owners

David Vallance, Chartered Financial Planner
19 September 2019

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Agenda

- (1) Case study - Carter and Carter
- (2) Case study - Biz Protect Ltd
 - a) Impact on the viability of the business
 - b) Concerns for the surviving shareholders
 - c) Financial uncertainty for a director's dependants
 - d) Liquidity concerns for the pension fund

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CARTER AND CARTER
Case study - no insured solutions in place


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2019

Carter and Carter



Case study from 2007

Carter & Carter
Group plc

- Philip Carter was founder and creator of Carter & Carter Training Group and also an honorary vice present of Chelsea FC
- He was the visionary, driving force, entrepreneur and influencer of his business
- 2005 company floated at £2.35 per share
- By April 2007 the shares were valued at just over £12 each
- Business valued at £550M - over x 5 growth in business value
- 500 employees around the world (Ruddington, Notts and also Australia, Japan and Germany)
- Tragedy - May 2007

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Carter and Carter



Case study from 2007

Carter & Carter
Group plc

- 2 May 2007 Philip and his son were killed in a helicopter crash on the way home from a Liverpool vs Chelsea game
- There was no succession planning in place for his business
- There was no continuity planning in place for his business
- June 2007 profit warnings (shares down 41%)
- Dropped 80% in July and firm failed to win a Government pathway to work deals
- Shares were suspended on the 3 October at 85p in value
- Early March 2008 the business entered into administration
- £100 million shares left to his estate were worthless

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Carter and Carter



Case study from 2007

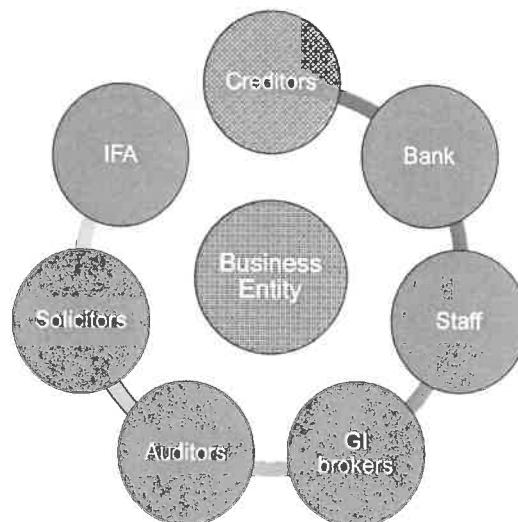
Carter & Carter
Group plc

- The speed of the change of fortune and value of this business is a salutary lesson
- Business owners are far too busy running their enterprises and making money and chasing contracts
- There is little time to reflect nor urgency to seek advice to construct a robust plan to mitigate unthinkable scenarios and events which will impact on their families and business associates and connections.

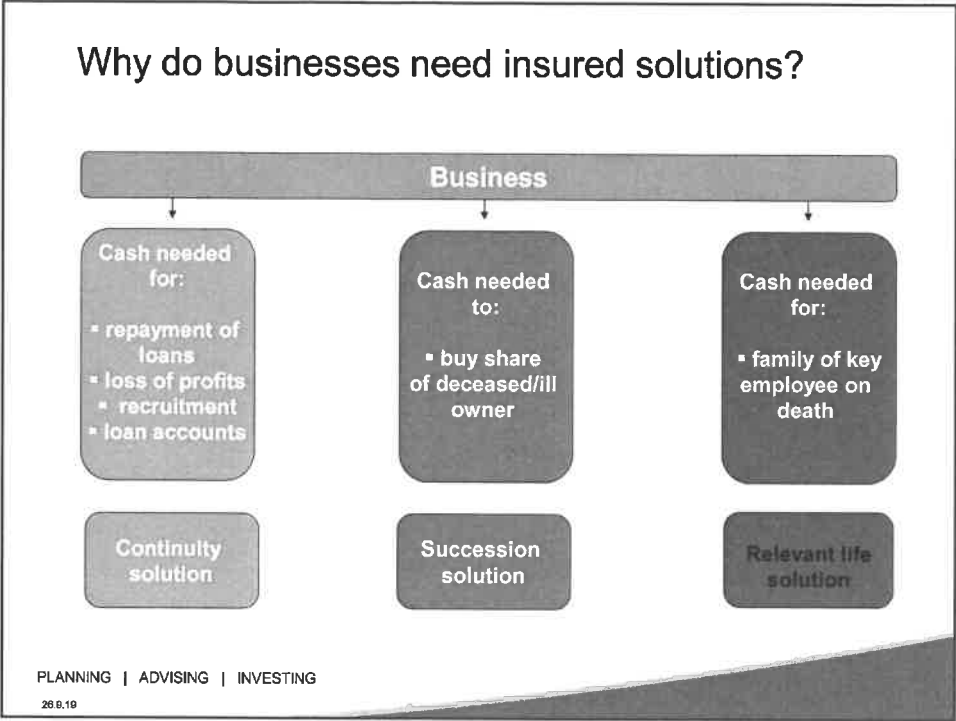
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Parties impacted by a failed business




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BIZ PROTECT LTD

Case study – insured solutions in place




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Directors of Biz Protect Ltd


Influencers and income generators?




James
Managing Director



Neil
Technical Director



Peter
Finance Director



Jane
Sales and Marketing Director

Vision
Direction
Leadership
Board
cohesion
Bank
confidence

Leadership

R&D
Quality
control
Buying
Projects
Contracts
Team leader

Production

Cash flow
Credit control
Cost control
Forecasting
Profit testing
Loans/capital
Tax
Co sec

Financial Control

Connections
Product and
market
Negotiating
Team leader
Exports

Sales

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Some statistics - what are the odds?

Probability of at least one director dying before age 65

| Number of partners or directors | | | | | |
|---------------------------------|----|-----|-----|-----|-----|
| Age | 2 | 3 | 4 | 5 | 10 |
| 35 | 7% | 11% | 14% | 18% | 32% |
| 40 | 7% | 11% | 14% | 17% | 31% |
| 45 | 7% | 10% | 13% | 16% | 30% |
| 55 | 5% | 8% | 10% | 12% | 23% |

Based on mortality data of 55% (Source - CMI working paper 75, calendar years 2007-1010) of TMN00 mortality table, male non smokers at 5+ years' duration

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Some statistics - what are the odds?

Probability of at least one director getting a critical illness before age 65

| Age | Number of partners or directors | | | | |
|-----|---------------------------------|-----|-----|-----|-----|
| | 2 | 3 | 4 | 5 | 10 |
| 35 | 24% | 34% | 42% | 50% | 75% |
| 40 | 23% | 33% | 41% | 49% | 74% |
| 45 | 22% | 32% | 40% | 47% | 72% |
| 55 | 17% | 25% | 31% | 38% | 61% |

Based on morbidity data of 102% (Source - CMI working paper 75, calendar years 2007-1010) of SC04 morbidity table, male non smokers at 5+ years' duration

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Directors of Biz Protect Ltd

What happens if



James
Managing Director

Vision
Direction
Leadership
Board
cohesion
Bank
confidence



Peter
Finance Director

Cash flow
Credit control
Cost control
Forecasting
Profit testing
Loans/capital
Tax
Co sec






Jane
Sales and Marketing
Director

Connections
Product and
market
Negotiating
Team leader
Exports

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Directors of Biz Protect Ltd


What happens if

| | | | |
|--|---|---|--|
|  James Managing Director | How will they source a replacement? What are the financial consequences? How will they support the family? What will happen to the shares? |  Peter Finance Director |  Jane Sales and Marketing Director |
| Vision Direction Leadership Board cohesion Bank confidence | | Cash flow Credit control Cost control Forecasting Profit testing Loans/capital Tax Co sec | Connections Product and market Negotiating Team leader Exports |

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CONTINUITY CONCERNS

Impact on business viability


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Biz Protect Ltd

Replacement costs

An example of the kind of costs that could be involved

| | |
|---------------------|----------------|
| Time | 6-12 months |
| Head hunter costs | £15,000 |
| Relocation costs | £30,000 |
| Share option buyout | £20,000 |
| Package | |
| • Car lease | £5,000 |
| • Salary/pension | £60,000 |
| • Bonus | <u>£20,000</u> |
| | £150,000 |

These figures are estimates – costs can vary greatly.

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Biz Protect Ltd

Neil's death and impact on net profit

Reduce turnover and cost of sales by 20% →

| | | |
|-----------------------|-----------|---------|
| Turnover | 1,200,000 | 960,000 |
| Cost of sales | 400,000 | 320,000 |
| Gross profit | 800,000 | 640,000 |
| Fixed operating costs | 600,000 | 600,000 |
| Extraordinary costs | 0 | 0 |
| Operating profit | 200,000 | 40,000 |
| Finance costs | 20,000 | 20,000 |
| Net profit before tax | 180,000 | 20,000 |

Still a net profit but reduced by 90%

NP pays the dividend remuneration of shareholding directors

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Biz Protect Ltd
Neil's loans and personal guarantees

- Director's loan account - £50,000
 - Repayable on death to deceased's estate
- Third party loans - £50,000
 - Apportion between all key people as unlikely that each key person will be covered for the full sum
 - Secured on business assets or personal assets
 - Personal security – potential shadow of a second charge on the family home if loans are not discharged on the death of the guarantor

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Biz Protect Ltd
Not forgetting additional revenue and capital payments

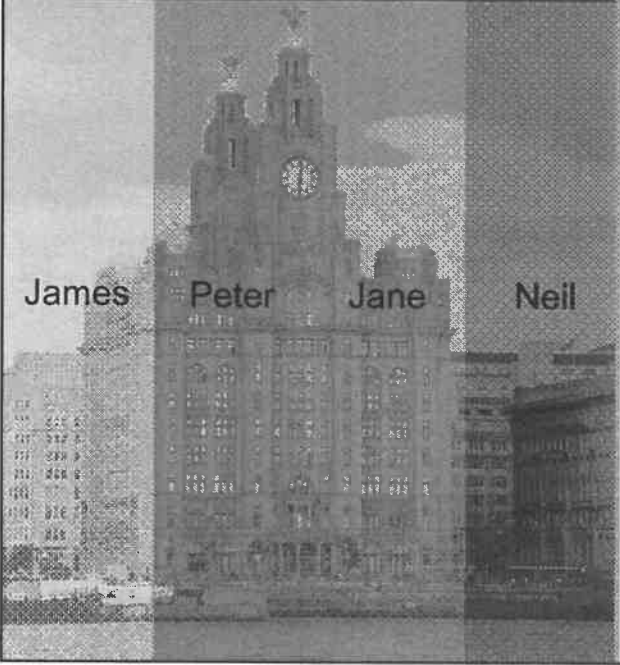
Add extraordinary costs

| | | | |
|------------------------|-----------|---------|-----------------|
| Turnover | 1,200,000 | 960,000 | 960,000 |
| Cost of sales | 400,000 | 320,000 | 320,000 |
| Gross profit | 800,000 | 640,000 | 640,000 |
| Fixed operating costs | 600,000 | 600,000 | 600,000 |
| Extraordinary costs | 0 | 0 | 150,000 |
| Operating profit | 200,000 | 40,000 | -110,000 |
| Finance costs | 20,000 | 20,000 | 20,000 |
| Net profit before tax | 180,000 | 20,000 | -130,000 |
| Capital costs (DLA) | | | 50,000 |
| Total cash loss | | | -180,000 |

£360,000


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Value of fund £400,000



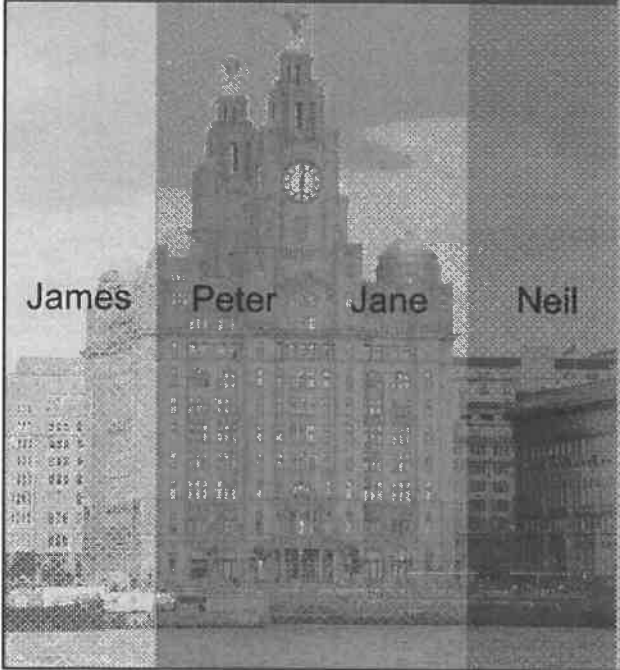
James Peter Jane Neil

BIZ PROTECT
SIPP




Neil dies
£100,000
ROF needs to
be found

Value of fund £400,000

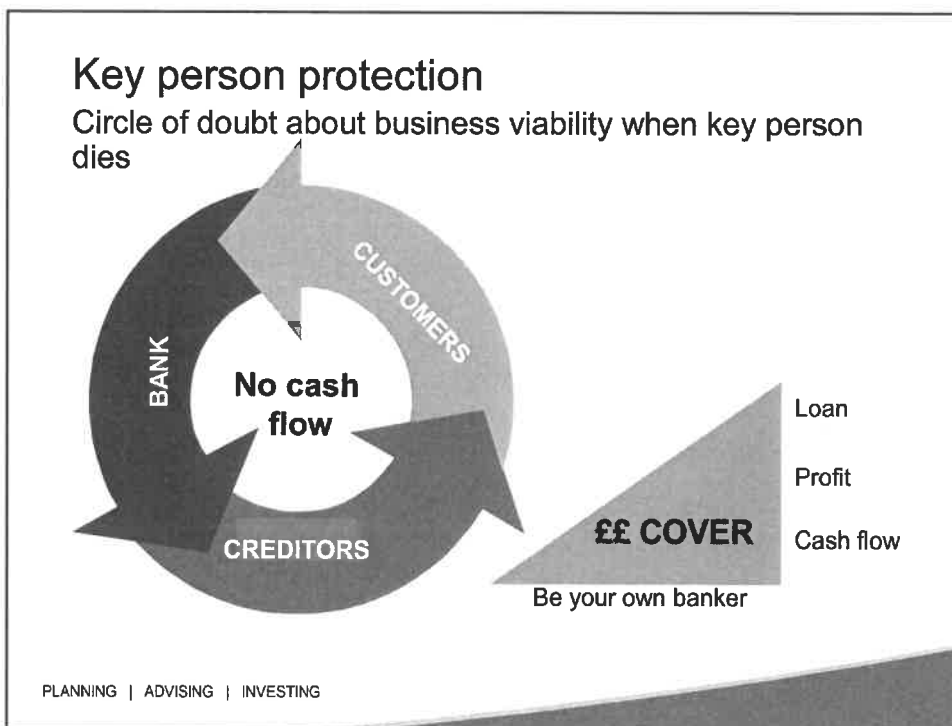
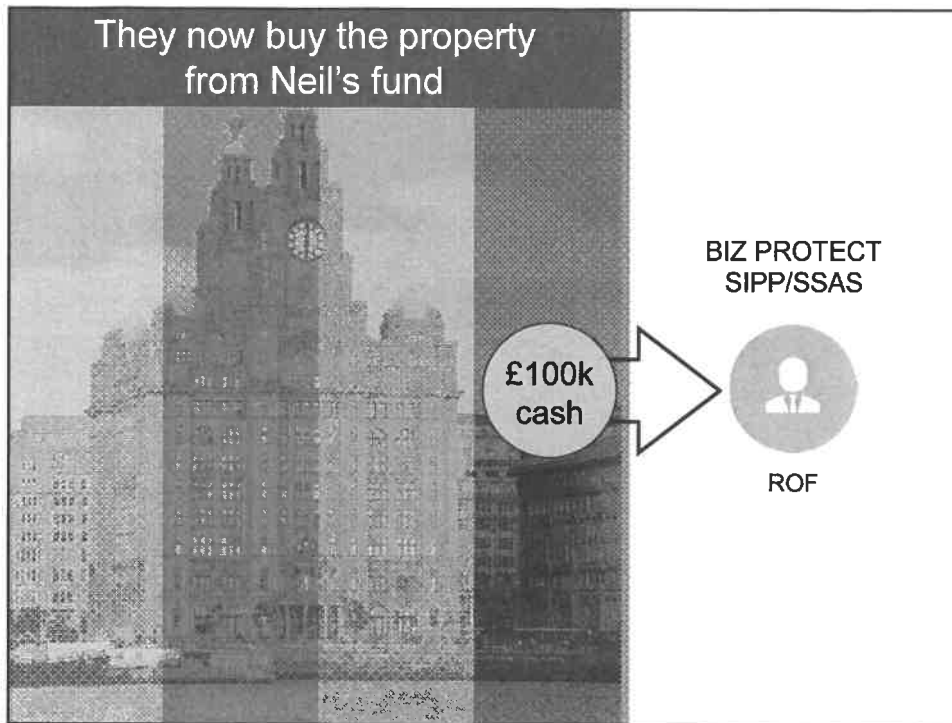


James Peter Jane Neil

BIZ PROTECT
SIPP



£100,000
(£33,333 each) paid
into James, Peter and
Jane's fund on death
of Neil



Biz Protect Ltd

How big is the wedge for Neil and continuity cover?

| | | |
|--|--------------------------|------------------|
| Need 1 key person cash flow | • Replacement costs | £ 150,000 |
| | • Director loan account | £ 50,000 |
| | • Bank loans & overdraft | £ 50,000 |
| | • SIPP liquidity | £ 100,000 |
| | • Contribution to GP | <u>£ 250,000</u> |
| | | £ 600,000 |

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SUCCESSION SITUATION

Position for Neil's family and business co owners


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Who has control of the Business

What are the options for Neil's wife?

| Shareholding | Level of control |
|--------------|---|
| 0-25% | Virtually no control Minority shareholder rights only |
| 26-49% | Limited 'nuisance' value Can block special resolutions |
| 50% | Balance or deadlock Depending on relationship |
| 51-74% | Working control Controls dividends and director appointments |
| 75-100% | Total control Change Articles, sell company, wind up, etc. |

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The 'business will'

Two parts

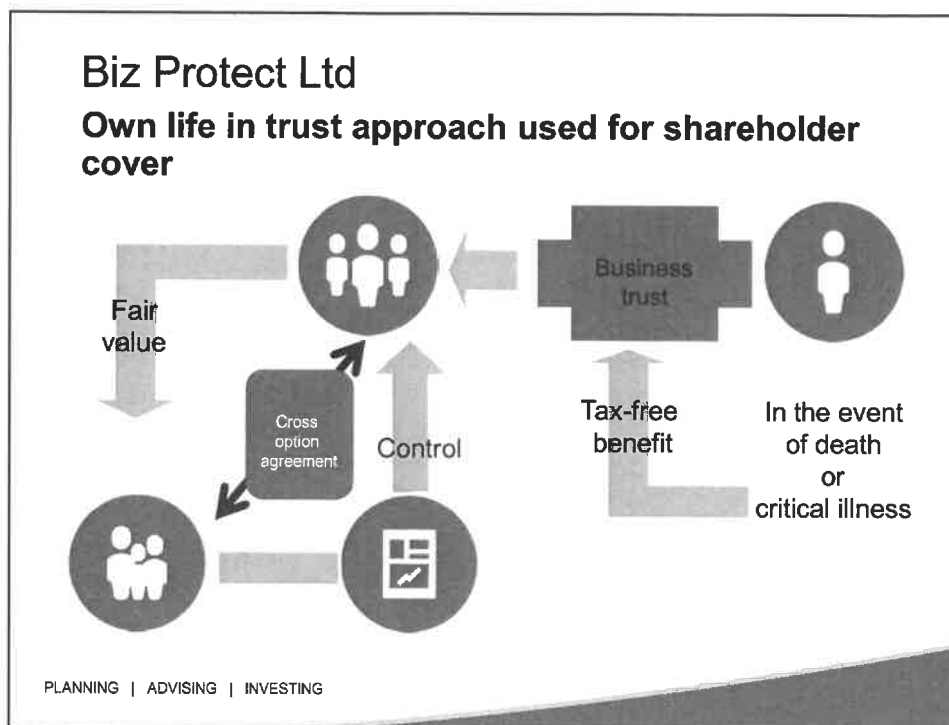
Fair value
The right money

Life/CIC
policy

Control for the business
In the right hands

Cross
option
agreement

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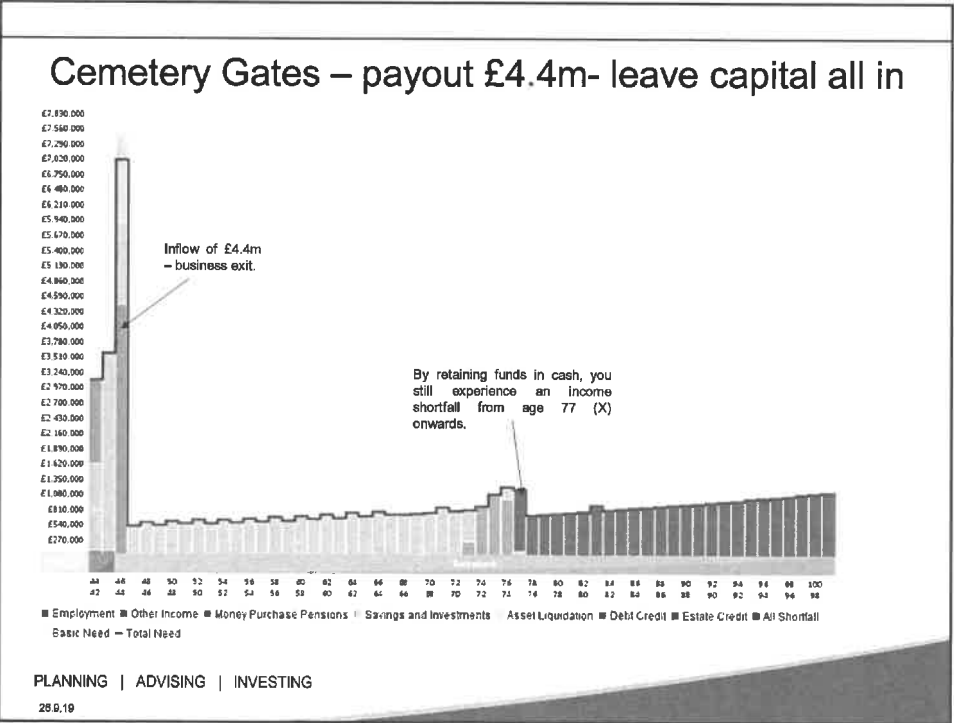
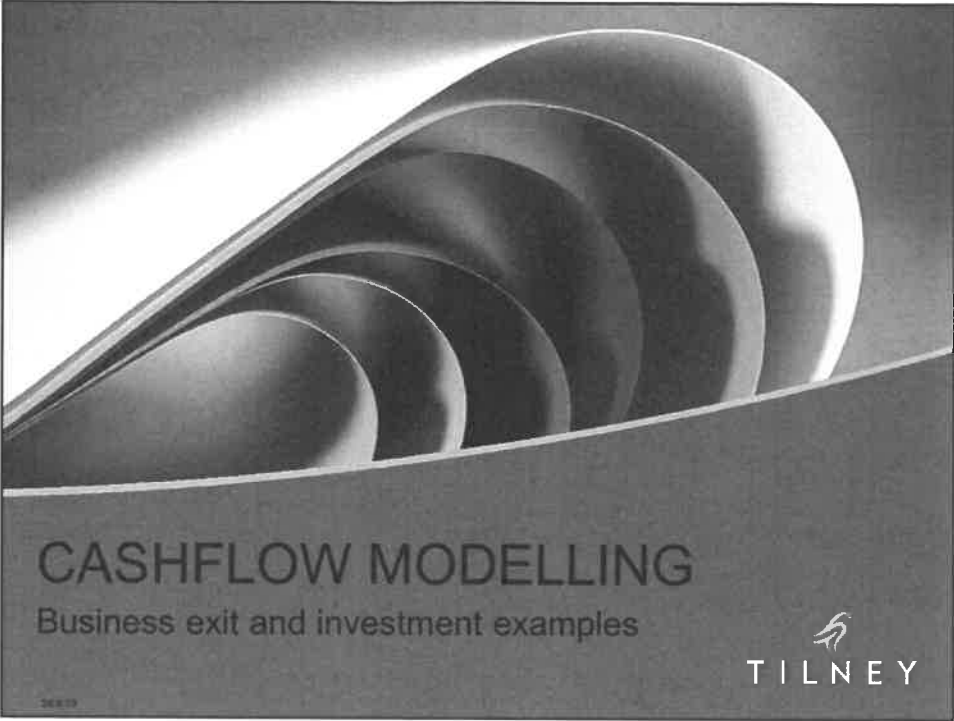
Work smart for business continuity and succession

Identify the risks and review contingency plans

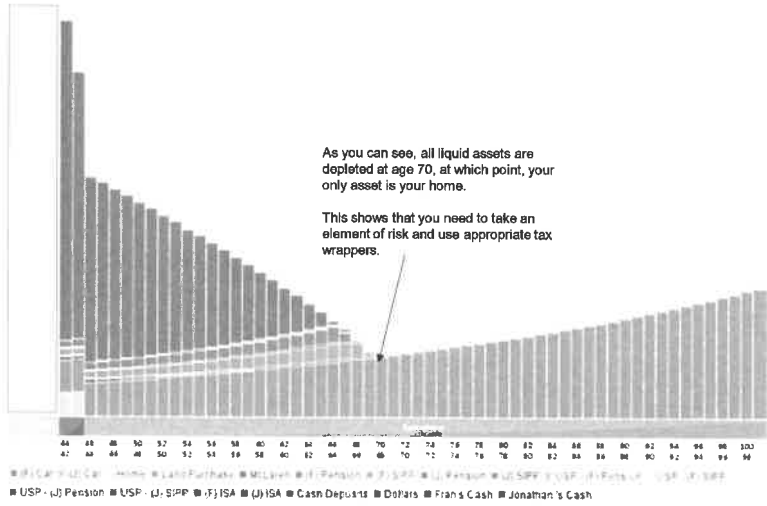
- Has a liability audit been completed?
- Who is key to the profitability of the business?
- What events could jeopardise cash flow?
- Is there a Business Will?
- Is there ready access to a cash injection when a co owner dies or becomes seriously ill?
- What support is there for the dependants of the business owners?

The Carter and Carter outcome could have been very different had the banks received injections of cash following the death of Philip Carter.....

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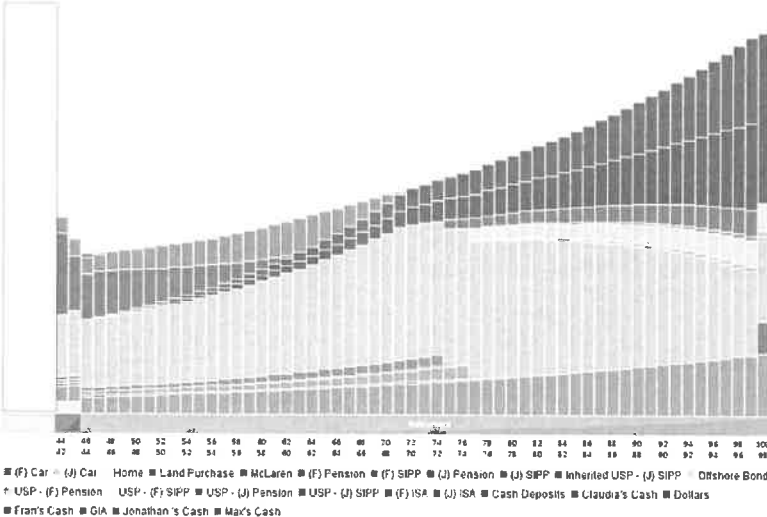


Cemetery Gates – leave in cash - underlying

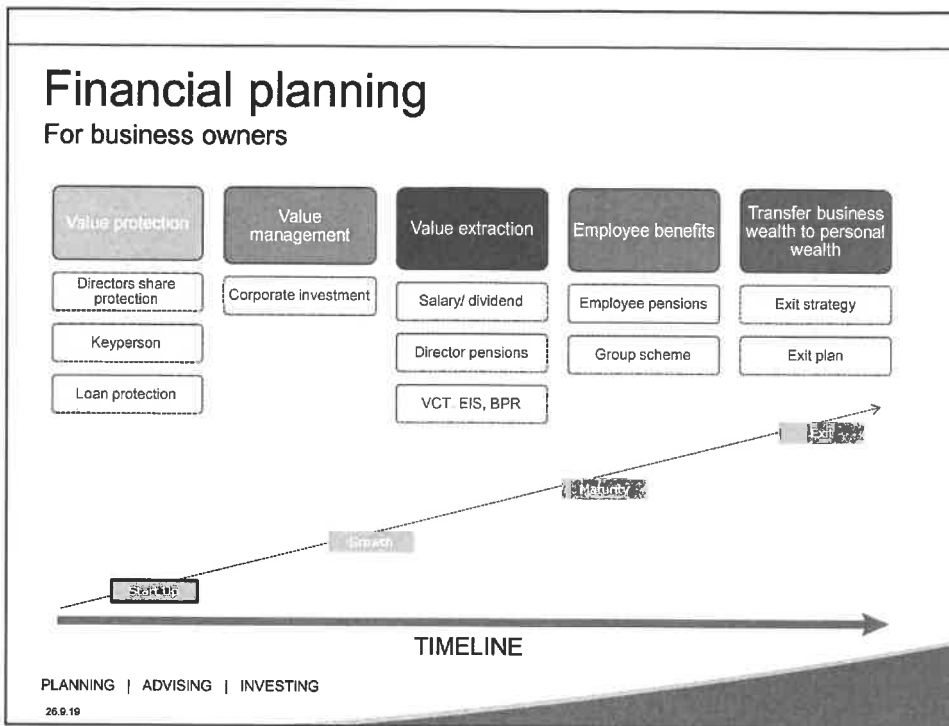


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Cemetery Gates – investment of underlying



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Important Information

This presentation is solely for professional advisers and should not be construed as investment advice.



The value of an investment may go down as well as up, and investors may get back less than the amount originally invested.

Examples of how tax or tax relief may apply are based on our understanding of current tax legislation. Whether any tax will be payable, at what level it is charged and whether clients qualify for tax relief will depend upon individual circumstances and may be subject to change in the future.

Clients must be reminded that tax advantaged products are higher-risk, longer-term and less liquid investments; they should only be considered once other planning opportunities have been fully explored and they should form only a small part of the client's portfolio. The levels and basis of taxation may be subject to change and may impact negatively on any such Investment. Clients should be encouraged to seek independent tax advice before considering these investments.



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Q & A

Any questions?

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