Transitioning a Funeral Home

The importance of evaluation and succession planning

By: Lisa Johnston

James T. Wong, director of succession planning at BMO Harris Private Banking

Although immersed on a daily basis in the business of death care, funeral home owners do not always think about their own mortality. As health issues can arise suddenly, this can leave a long-standing business in jeopardy. For this reason it is important to consider succession planning.

"When we look at a business…where the owner is over 50, we say it's prudent to look at succession planning even though you may not be succeeding your business for another two, three or five years," says James T. Wong, director of succession planning at BMO Harris Private Banking. "But it's prudent to look at your options and to plan your exit. Part of that might be some tax planning, some operational planning or you may have to upgrade the look of your funeral home to attract a greater price for your home. You might want to do that ahead of time as opposed to the eleventh hour before you sell your funeral home."

Wong explains that the succession process starts with the owner developing objectives and a vision, including what they view themselves doing in the future.

"One of the chief impediments to an entrepreneur commencing a succession plan is a lack of vision of what he or she will do once they divest of their business," says Wong, who specializes in succession planning across Canada in many different industries. "Once that vision is set, I generally find that the other pieces tend to follow. They know what they want to do. They can see themselves…in a lifestyle beyond the business. They might even think about owning another business but having said that, until they've developed that vision, the succession planning is hard to start."

However, before succession planning can begin Armand Lagace, owner of Lagace Connecting Link Inc., says it is important to evaluate the business. This includes a complete analysis of all aspects of the business. While succession planning is one of the reasons that funeral homes undertake the process of evaluation, Lagace says it is also an important tool for making improvements to a business such as refinancing the business for refurbishing, adding an addition, upgrading the fleet, financing the purchase of a new business or selling or buying a funeral home at the fair market value.

"The evaluation is based on the current market value of

Succession Planning Timeline

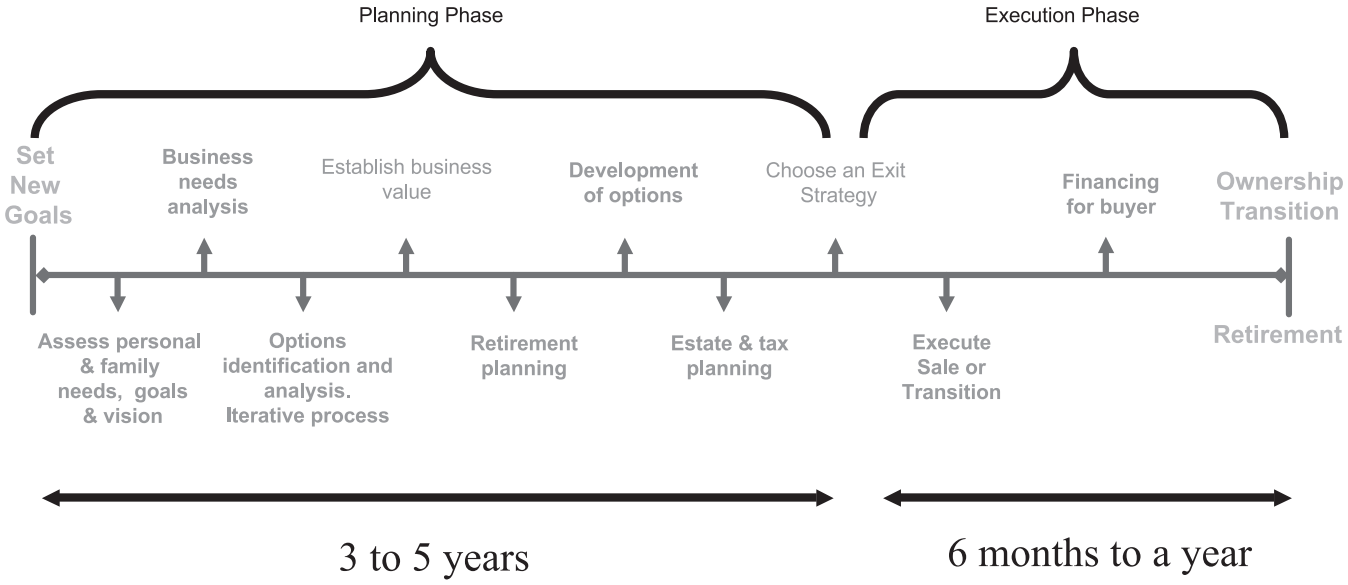

Chart courtesy of BMO Harris Private Banking

Both Lagace and Wong agree that knowledgeable staff can also increase the value of the funeral home.

the business as well as the current share value of the business," says Lagace, who works with funeral homes across Canada.

"The process of an evaluation is to do an in-depth analysis of the cost of operation and administration without all the extraordinary expenses. It analyses the cost and retail price of all the merchandise to determine if the percentage of profit is adequate," says Lagace, adding that it is important to understand the cost structure so funeral home owners can make necessary price adjustments.

"We do a sales tracking chart by studying every single contract signed with the family and we do analyse the types and the qualities of the calls for the last three years to determine the net sales without disbursements," says Lagace. "So this sales tracking chart may realize that service charges and merchandise need price adjustments."

Lagace says an evaluation should also include accounting groupings for the general ledger, statements of income and cash flow files and recommended adjustments for cash flow success.

"When we do an evaluation, it is really a guideline for improvement," says Lagace. "Should I sell my business or should I not sell my business? Well maybe this year, according to your evaluation, you should improve your business and restructure for a year or two years or three years and then…it will be time to do the succession planning."

If the final decision is to sell the operation, funeral homes usually fetch a high price for two main reasons – cash flow is relatively stable and assets are high.

"If you're a well-established funeral home you don't expect your cash flow to vary too much," says Wong. "The death rate in your community doesn't vary that much…and you should get a certain level of funerals per year… Any investor who looks at the stable cash flow loves it."

Combined with a stable cash flow, funeral homes also have large assets that often outstrip the real value of the business. Included in the assets is real estate (the funeral home building itself), cars and other equipment.

"The other nice thing about funeral homes is that once you've got a funeral home and you've built it and you've up kept it, the general capital expenditure that you need to incur to sustain cash flow is very limited," says Wong. "You might have to replace a hearse every few years. There's really no huge capital expenditure that is incurred as opposed to a capital intensive-business."

Wong adds that due to an increasing elderly population, funeral homes are deemed a lucrative business. However, Wong states that the breakdown between traditional funeral services and cremation can also affect the asking price.

"In a province like Ontario, there's a higher burial percentage versus say out West where the percentages are lower," he explains. "The tendency is to have more revenue generated from a traditional funeral service versus one that isn't."

Armand Lagace, owner of Lagace Connecting Link Inc.

"We study every single contract signed with the family…and we do a study of the types of calls and the qualities of the calls," says Lagace. "So that means finding out if they had direct disposal or cremation with a memorial service or other things. We analyse that through the contract and we put that on paper."

As the funeral business tends to be a family affair it is common practise to pass the funeral home to a family member. If this is a consideration, Wong says it is important to determine if the children want to be involved in the business and if they have the capability to bring it to the next level. He adds that many funeral homes also bear the family's name which becomes a legacy issue and is an additional incentive for a family member to take over the reigns of the business.

If a family transition is not an option, Wong says one or more funeral directors associated with the business may be interested in becoming the new owners of the facility. If this option is also not available an outright sale to a third party may occur.

Depending on the succession plan developed, an existing owner may choose to stay involved during the transition period.

"If the buyer is a consolidator…I think it's very important and in fact it adds value to the transaction if the seller, the owner of the funeral home, says they will stay around for the transition period and be the face of the funeral home."

However, Wong adds that while it is OK to remain a figurehead at the business, it is also vital to step away from the day-to-day operations. "It is very important that the owner makes himself or herself more transparent to the business as they progress through a point of time where they'll be transitioning their business. If they're very much involved it becomes an issue sometimes for a buyer because the relationships, the know-how or all the knowledge to run the business is in the owner's mind. So the more that involvement of running a business is detached from the owner, the more value a buyer is willing to give to the acquisition because it lowers what we call the transition risk factor."

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~Wong

Unfortunately, stepping away from a business is hard.

"It's very easy to get immersed in your business," says Wong. "It is very easy not to think about stepping back and then the day comes, either it's because there's a health scare or the thought of retirement becomes stronger, that they

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find themselves in a huge bind because there's no one they can train in short order to take over what they do. But that's human nature. Most funeral directors are in the business because they enjoy their work and if you enjoy doing something you tend not to let go."

Both Lagace and Wong agree that knowledgeable staff can also increase the value of the funeral home.

"Whether it's a private buyer or a consolidator coming in, one of the first assessments is who are the key employees and what is the probability of retaining them once the funeral home has been acquired. That becomes a huge issue. In fact it could be a deal breaker if say the buyer feels that a key employee who has a lot of relationships for instance, who runs the business hands on, is not going to stay around for whatever reason. You lose a lot of value because in any business the value is in your people."

Wong stresses it is also important for new owners to keep the original name of a funeral home as the majority of the public choose a funeral home because of convenience and tradition.

"I think at the very least it's prudent for a new buyer to keep the name for at least some time period until they've built up their own goodwill and their name in the community. And a consolidator…generally keeps the name because they don't want the local community to know that the funeral home is owned by a large corporation somewhere far, far away. They want to keep that local flavour and that local presence so the names in those cases are seldom changed."

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As the details around evaluating a funeral home and succession planning are cumbersome, both Lagace and Wong suggest that owners begin the process early. Lagace explains that he provides his client with a number of schedules to assist the funeral home owner with compiling all the necessary information such as staff salaries, equipment, market demographics, competition and pre-need programs, just to name a few.

"This is very daunting for funeral home owners," says Lagace. "They can get very discouraged and not know where to start. We will do it for them in their premises with their help."

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