Business

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Over the past 41 years, American Funeral Consultants has assisted hundreds of funeral home owners throughout the United States in the process of succession planning. Deciphering needs and goals, examining and analyzing the corollary effects of plans and orchestrating a strategy to ultimately assist clients in the transition of their business to family members, business partners, trusted employees, neighboring funeral firms or consolidation companies all are crucial elements of the succession planning process.

Many independently owned funeral businesses have more than one owner who may be a family member, or in some cases a partner, who has a relationship with such longevity that it has become familial in nature. In some cases, the partner is actively involved in the day-to-day operation of the funeral home, while in other cases he or she is not involved and plays no role, having only a monetary interest in the business. The ownership structure can potentially work to create very delicate situations that require special handling. Often, these factors represent just the tip of the iceberg, and there may be other inconspicuous underlying elements that need to be tactfully addressed. In AFC's experience, no business, no family situation and no ownership or partnership has ever been exactly alike. Thus, as you confront your own succession planning, it is imperative to arm yourself with knowledge and awareness, plus receive advice and assistance from experienced professionals.

Value of Funeral Home Real Estate

Over the years, we have seen transactions ranging from a "gentlemen's agreement" based on a handshake to hostile takeover situations. To cite examples covering the gamut of what can occur would make this a very lengthy piece. However, there are some situations that are especially common among the general population of funeral business owners. One of the key and potentially challenging issues has to do with the value of funeral home real estate, which can cause disharmony among shareholders, family members, heirs and others closely involved.

For example, in one recent situation there were two equal owners of a funeral home that had a small (less than 75) but steady call volume, strong net revenues and a stable mix of calls in an affluent and established market area. The real estate was held in a separate corporation with the same ownership structure as the funeral home. One partner had been uninvolved in the business for many years and wanted to be bought out of his shares of the real estate and business by the active partner. Acting in what he felt was good faith, the remaining partner had the real estate appraised and began the process of the buyout. Based on that appraisal, both parties agreed on the dollar amount and the inactive partner's shares of real estate were purchased by the active partner. At first glance, this seems reasonable and rational and the active partner was pleased to have one part of the transaction behind him. However, because he had not done enough background work and had not armed himself with enough information before he jumped into this succession plan, it soon became clear that this approach created a big problem for the soon-to-be sole owner of the business.

Following the purchase of the real estate, he contacted AFC to conduct an appraisal to determine the fair market value of the business. The problem is that when valuing a funeral home, you cannot simply add the market value of the real estate to the value of the business to derive the total. In this case, the entire business entity including the real estate was worth little more than the value established by the real estate appraiser for just the real estate. Did this mean that the business was worthless? Absolutely not – it was a very good business with excellent potential. But this is a common dilemma that boils down to the fact that if that real estate were sold for some other purpose (leaving the funeral business to either close down or move to a new facility) the parcel may well have warranted such a value. In reality, the funeral business simply did not give off enough cash flow to afford its real estate at that price.

To ensure the ongoing success of a funeral business, the value of the real estate must be imputed based on what the business can afford to pay for it, regardless of what it might be worth on the open market. That value is derived from several factors, but is driven primarily by the firm's net revenues and cash flow, and often this value is less than the market-driven value. Understandably, this often presents a dilemma for owners. But being aware of and comprehending this possibility before proceeding with your plan can help you lay the proper groundwork before it becomes an issue.

Fair and Equitable Treatment

When there are multiple shareholders within a funeral home, another issue often surfaces that involves the fair and equitable treatment for all owners. Such a circumstance emphasizes the importance of having a comprehensive, impartial and fair appraisal of the business. AFC was fortunate and honored to have been selected to carry out a business appraisal for shareholders John, Bill and Maggie McQueen of Anderson-McQueen Funeral Homes in St. Petersburg, Fla. When all was said and done, as Bill McQueen put it so succinctly: "Family is family." The McQueens were forward-thinking in their approach to their succession plan. They kept the lines of communication open with each other and they sought out and interviewed industry experts to help guide them through this decision-making stage of their lives.

In the case of Anderson-McQueen and many other businesses that have similar ownership structures, an impartial appraisal that incorporates all of the integral and unique aspects of the entity or entities being appraised is imperative. It should provide a clear and comprehensive treatment of all of the factors that together make the organization whole, and the overall goal should be the fair treatment of all those who are involved. In these situations, the simplicity of fairness overrides many potential stumbling blocks that can get in the way of a successful transition.

Another key issue that many funeral home owners are faced with is, "Can I afford to sell?" For example, consider the funeral director who has worked in the funeral home since he was a child, is now burnt out and is ready to retire and enjoy some time with his wife. While the funeral home is spectacular, some major additions and renovations to the facility in recent years did not result in the expected immediate upsurge in calls, and an appraisal of his business determined that a sale of the funeral home would not generate enough income to enable him to retire right away. So even though the additions and renovations added "value" to the real estate, the resultant cash flow has not increased enough to support the sale price needed to fund the owner's retirement.

As his adviser, AFC tested the market extensively seeking to obtain his desired purchase price, but at the same time we knew we needed to devise a back-up plan to his immediate desire to sell. After working closely with the client and his financial adviser and accountant, it became clear that the best solution was to bring in an employee who was willing to work for a few years with the option to buy the firm at a mutually agreeable future date. While the details were intricate and many , this arrangement allows for many things, including the gradual growth of the business and a resultant increase in cash flow, and it provides the owner with the opportunity to pay down the debt associated with the loans for the renovations, as well as with a future exit/entrance strategy, while providing some immediate relief for the owner from some of the day-to-day responsibilities. Simultaneously, it provides the employee with an opportunity to buy into the business at a price fair to both parties, and with a properly structured vested interest, he will be motivated to grow and strengthen the business.

Another common scenario in the industry is one in which an owner transitions a business to a son, daughter or even a longtime trusted employee. The owner has likely worked at the business for most or all of his or her career and made many sacrifices, invested a lot of blood, sweat and tears in the business, experienced the ups and downs of cash flow and struggled to pay down debt. A dilemma often arises about what a "fair" purchase price might be, especially in the case of a transfer to a son or daughter . It can be a colossal task to balance family relations with a purchase price that is fair and reasonable to all parties. AFC has been involved in many such situations and has played the role of mediator. Whether the owner has inflated expectations of the value of the firm, or the buyer feels it is his or her "right" to waltz into ownership with ease and minimal expense, a properly laid plan based on a formal business appraisal can level the playing field and facilitate a transaction that is fair to everyone involved.

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Starting Your Succession Plan

AFC believes that effective succession planning is best accomplished through a progression of strategically plotted events that are planned to occur within some predetermined time frame, rather than having one's hand forced at the time of a crisis or life-changing event. Whether the goal of a succession plan is to set up an estate, to arrange for the incremental transference of stock or to transfer ownership of a business upon the owner's disability or death, AFC strives to help its clients reap the fruits of their labor by addressing such issues as potential tax consequences, local, state and federal legal issues, and realizing sufficient economic rewards in the form of cash, retirement income or other forms of compensation. It is imperative for all of your advisers to work collaboratively to accomplish your goals.

There are many reasons for deciding to sell your business, but regardless of the motivating factors, advance planning will help to reduce the trauma and stumbling blocks that are so often a part of the sale process. Planning ahead is important whether a sale is contemplated over a period of time or is dictated by an unexpected event. But before you even begin to create a succession plan, certain basic elements should addressed:

1) An updated will should be prepared.

2) Durable powers of attorney should be established.

3) Health care directives and proxies should be recorded.

4) Protective legal trusts should be created.

All of these issues should be handled by qualified financial advisers, accountants and attorneys who specialize in estate planning and have extensive experience with current tax laws.

Once the essentials have been addressed, a team of advisers should be put into place. Your team should include an accountant (extensive experience in funeral service is an added bonus), a transaction attorney and a funeral industry expert/business appraiser. These advisers should work collaboratively to help you set particular goals and to develop short-term and/or long-term exit strategies.

The team should assist you in constructing a "wish list," taking into consideration both objective facts and emotional sentiments. Such a list should clarify specific objectives before you become deeply enmeshed in the sale process. Be certain to understand the latent as well as the manifest reasons for selling your business, determine if this is the right time to sell, and specify what you expect from the sale. Such objectives may include a specific desired after-tax result, whether you prefer a cash sale or some variation of an installment sale, how you could secure deferred payments, the possibility of continued employment for you or your employees and whether to sell or lease the real estate.

With your team of advisers assembled, you can better focus on some of the critical issues that you as the owner should consider as you contemplate your future:

• Who will manage the financial matters of your firm if you become ill, incapacitated or die?

• Do you have key employees who can step up and operate the business?

• What incentives keep your employees loyal to you and your firm?

• Are there other shareholders who have certain rights within your business?

• Are there legally binding agreements covering the termination or transfer of ownership shares due to death, disability or other events?

In addition, regardless of who is the intended successor, you must determine which assets will be included versus those that will be excluded in a transfer or sale. Consider what is important and necessary to convey in order for the business to be turnkey and to continue as a going concern. Is it the tangible assets, its particular location, the firm's goodwill or the professional staff that is most valuable to a buyer? If there are employees who are crucial to the operation, are there assignable employment agreements? Those assets that are necessary to the ongoing success of the funeral business should be conveyed in some manner in a sale.

As implied in the earlier cited examples, an essential element in your succession planning is an appraisal to establish the fair market value of your business. This may well be a determining factor in your decision to sell or not sell. Generally, the valuation will be keyed to such factors as book, liquidation or appraised values of assets; cash flow; earnings before interest, taxes, depreciation, and amortization; discounted future earnings; dividend history or a combination of these factors, and then the subsequent application of multipliers or capitalization rates. A comprehensive business appraisal should examine the firm's costs and expenses to identify those that are owner-discretionary versus those that would remain constant after a sale. In contemplation of a sale, discretionary items should be reduced or eliminated to provide cleaner records and to present a more accurate picture of the actual bottom line.

Given the unique elements of

funeral service, it is important to involve a funeral industry expert who understands the intrinsic elements of the field, rather than a general appraiser who may not be familiar with its unique issues.

Preparing for a Transition or Sale

We suggest that about two to three years prior to a contemplated sale, you should begin to make some adjustments and modifications to make your company more operationally efficient and sound. A valid and reliable business appraisal will help you determine ways in which you can strengthen your operation to make it more salable in the future, if that is your goal. Your appraiser should be able to assist you in taking the critical steps needed to present the firm in the best possible light when it ultimately is offered for sale. Your appraisal should incorporate the historical and current financial records of the business and a detailed analysis of the revenue streams of the business. The various types of calls carried out by the firm each generate income from the sale of services, merchandise, facilities, automotive equipment and other sources. This information can be a valuable tool for current owners in gaining a better understanding of their business and helping them groom the business for its future sale. This information also is invaluable to potential new owners who seek to understand the business more fully.

As you prepare your business for a transition, especially a sale to a third party, it would be beneficial to carry out a presale assessment to address any potential issues and to avoid surprises – and even in some cases, embarrassment. Together with your team of advisers, you should examine legal matters such as government regulation compliance, review the condition of the physical assets and conduct an audit of your preneed accounts. If something is amiss, such as an underground storage tank or friable asbestos, or a shortfall in preneed funds, you will regret learning about the problem from a potential buyer carrying out their own due diligence. Such problems can turn out to be deal-breakers, leaving you with “problem assets” and no buyer. So, it makes sense to do your homework to uncover and address any potentially problematic issues in advance.

In a sale situation, the due diligence process involves the careful examination and scrutiny of all aspects of a business that an ordinary and prudent person exercises for his or her own protection when buying a business. In the funeral industry, buyers should examine such things as funeral purchase agreements, preneed contracts, real estate deeds, binding contracts, automotive equipment, furniture and fixtures, accounts receivable, accounts payable, merchandise inventory, income tax returns, financial statements, insurance policies, employee information and price lists. A review of these documents by the owner in advance will facilitate the sale process when a potential buyer carries out his or her own due diligence.

Marketing for a Sale

Many funeral home owners throughout the U.S. have no family members to whom the business can be transitioned. If that is your situation, another step is necessary in your succession plan. Namely, now that you have formed your advisory team of experts, created your succession plan, addressed relevant legal issues, commissioned a business appraisal and taken the necessary steps to ready your firm for a sale, the next matter to be addressed is how and to whom the business will be marketed.

Generally, the pool of potential buyers and the circumstances surrounding the sale will influence the method of marketing to be used. Commonly, funeral home owners have some ideas about who might be a potential buyer. It might be an employee or former employee, a neighboring firm, a competitor or an old friend in the field who said, “When you decide to sell, please give me a call.” Another source of potential buyers is in the form of offers made long ago by one or more of the large consolidators. And, of course, there is the grapevine list of those who are looking to buy a firm, often derived from sales representatives who visit your firm to sell supplies, merchandise or equipment. Finally, professional negotiators generally have a database of potential buyers as well as myriad contacts in the field. It is sensible to develop a target list in conjunction with your advisers and to open the sale up to as wide a market as reasonable. However, simultaneously, it is important to design a game plan that will minimize the firm’s exposure to the public eye while maximizing the potential for attracting a variety of potential purchasers.

Satisfying and Profitable

As a funeral home owner, you thoroughly understand the importance of planning funerals that meet the needs and desires of your families. You also know the business aspects that must be addressed on a daily basis to ensure the overall success of your operation. But many of the aspects of succession planning can often fall outside the realm of your expertise. At this stage of your professional career, there will be a need for some of the most important decisions you will ever make.

Regardless of the size of your business, a well-executed succession plan can go a long way in making the transition of your funeral business more satisfying and profitable, and it is essential for you to understand the process and to know what to expect. Furthermore, having an exceptional and experienced team of advisers on your side will enable you to continue serving your families with the care and expertise they have come to expect of you while your advisers tackle the often mundane, yet highly critical details of your future as well as that of your business. ❖