



Don't Buy a Job... **Buy a Business**

By Sean M. Wonder & Rebecca Stoedter

Every mortuary school produces eager graduates that are ready to take on the challenging career we all know as being a funeral director. Some graduates simply want to be an employee at a firm while others have the dream of one day owning their own business.

Both goals are achievable in today's market, especially given the changes seen in lending practices as well as the increasing numbers of owners that are nearing retirement age. This makes quality funeral directors in high demand and provides many opportunities for both employment and ownership.

Should a funeral director choose to fulfill their dream of owning a funeral home, one should make certain of what exactly is being purchased. Are you buying a business or are you buying a job? That is an odd question, but it is a very important one. Let's discuss this in a little more detail, as you might be surprised or even shocked at what you might really be buying.

We will explore a few of the main areas that will need full attention if entertaining the notion of buying a funeral home. Unfortunately, in many instances, a buyer will jump head-first into a purchase with little or no guidance. First-time buyers should never enter uncharted territory alone. Having no one in your corner is a huge mistake and potentially a very costly mistake. When considering purchasing a business, the very first thing to do is hire an expert. And not just an expert that spends a lot of money in advertising to present the illusion they have all the answers. An adviser who is bound by certain legal, professional and ethical standards is the only option. Why? Purchasing a business will most likely be the largest investment

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one will ever make. Yes, you read that correctly. You are buying an investment. The purpose of investing your time, money and energy into a business is to get a return on your investment while at the same time earning a living. Those are the goals. But are these goals achievable?

Do yourself a huge favor and proceed with caution. Be armed with sound advice and proper guidance. When seeking a source of guidance, buyers need to look for a professional specializing in the financial aspects of the funeral industry. The professional hired needs to be familiar with purchase agreements, entity structures, noncompete contracts Business By Sean M. Wonder and Rebecca Stoedter Don't Buy a Job ... Every mortuary school produces eager graduates that are ready to take on the challenging career we all know as being a funeral director. Some graduates simply want to be an employee at a firm while others have the dream of one day owning their own business. Buy a Business and last, but certainly not least, taxation. These are just a few of the important areas. The list can go on and on, as every deal is different. With what is trending in our profession, let alone the turmoil in the world, you could very well have your hands full. But with due diligence and quality advice throughout the process, you can greatly increase your chances of success. Remember that buying a funeral home will have a tremendous impact on your remaining working years and quality of life. How you negotiate the deal will determine

your future earnings, your retirement, along with your financial security and happiness.

Always remember this very simple piece of advice: "You can never recover from overpaying." If your purchase is overleveraged and has a huge debt to service, you may have given up ever receiving a return on your investment. In these situations, you purchased a job. Why take on the challenges of ownership if there will be nothing more than employment in return? No one should have to buy their job.

If you are looking into buying your own funeral home, there is a very fitting and appropriate term, "caveat emptor," which is Latin for "let the buyer beware." If that doesn't get your attention, nothing will. Conduct your own due diligence and listen to the professional you have hired to advise you. You cannot afford mistakes.

An important note is that an attorney will approach the deal with the goal of providing the buyer legal advice and protection while an accountant will look at it from a tax point of view. Buyers need both angles, and it may require hiring more than one professional to get the best advice possible. Potential buyers are oftentimes limited on resources and think they cannot afford to hire someone to guide them through the complicated process. Unfortunately, it is all too common for buyers to

rely on the lender, the seller's broker, or even the seller for advice and to set the selling price and sale structure. All of them have a vested interest in one thing and one thing only: selling the business for the highest price possible. Brokers charge fees based on the selling price, the seller wants the most possible in return for all the years of hard work and dedication, and the lender wants to sell as much money as possible in the form of a loan. In short, the deal will be structured in favor of the seller.

If a buyer cannot afford his or her own adviser, then they simply cannot afford to buy a funeral home. It is imperative in all circumstances to obtain unbiased and professional advice. No exceptions! Period. If that is a reader's only takeaway from this article, then it has served its purpose well.

The complicated intricacies of a deal and its structure will be saved for a little later. For now, let's discuss the many changes that our industry is facing and why these are important. As with anything in life, there are good changes and there are bad changes. But remember, changes can create great opportunities for one willing to accept the risk. It will depend on how the changes are handled as to whether the outcome is good or bad. Nonetheless, a buyer must be aware of these risks before taking the plunge into ownership.

One of the biggest changes is that revenue streams are declining and have been for quite some time. Families are simply spending less. Some experts say families are not spending as much as they have historically because the value of a funeral or memorial is seen as less important to them than in the past. The spending habits of families is a topic that certainly has enough fodder for a future article, but the point is that statistics reflect that most families being served desire to have some form of memorialization. What that something is or will be depends entirely on the individual funeral director making the arrangements. Funeral directors who make themselves relevant in the arrangement conference and provide five-star service consistently prove the point that most families do not opt for either an immediate burial or a direct cremation.

Why is this important? Because you are buying the future cash flows and earnings potential of the business. With revenue streams trending downward, that means a funeral home is worth more today than in the future. One only needs to look at some of the major players in our industry. Declining revenue streams have forced many companies in our profession, especially suppliers, to consolidate, merge, or even sell out altogether. Some have even closed their doors. Right now, growth in funeral service

is achieved mainly through acquisition. Why are they consolidating at a record pace? Economies of scale. In other words, it is more profitable to run several locations simultaneously. This gives the economic advantage of spreading operating costs. Reducing operating costs in a business that is experiencing declining revenues is the only way to show a profit. It will become more and more challenging to operate as a stand-alone entity, especially when servicing a large debt. Multiple rooftops may very likely be the future of owning and operating a profitable funeral home operation. That is yet another topic for another time.

Since the buyer is purchasing future cash flows of the business and those cash flows are projected to be less in the future, buyers need now more than ever to look at not only at the selling price, but how the sale is being structured. If the buyer isn't armed with the proper advice, it simply means everyone involved besides the buyer has a vested interest in getting a premium selling price. That is wonderful news for the seller, but more than likely, the buyer will end up overpaying by a considerable sum of money. Once again, it is important to remember that it is impossible to recover from overpaying.

How does one avoid overpaying?

Your adviser will conduct an independent valuation of the business and will provide an opinion as to the fair market value of

the business. The adviser's goal is to make sure it can make cash flow. This means the business can pay its bills and show a profit, in addition to you as the owner receiving a reasonable and market level salary. In business, profit spells survival. There are as many ways to calculate the values of cash flows for funeral homes as there are calculators. For those who have been involved in funeral service for any length of time, all have heard "\$10,000 per call" or "a multiple of revenue" as the gospel on how values are placed on funeral homes. These formulas are too general and broad. They are also outdated as we have already discussed the trend of declining revenue streams. Rumors have circulated for years that the major consolidators in the late '80s and into the early to mid-'90s used these same formulas. These formulas most likely contributed to the disastrous financial consequences many experienced after significantly overpaying and being overleveraged.

As a buyer, you want a conservative value based on the statistics and trends within the industry. The seller can ask for the moon and the buyer can offer below market all day long. This is called negotiation. But in the end, the price will be determined by: (1) the amount that a seller is willing to part with the business, (2) the amount the buyer is willing to pay, and (3) what a lender is willing to lend for the acquisition. The negotiation process can take quite a while, so

all parties need to be patient and keep in mind these transactions do not happen quickly and certainly not overnight. There are many players involved and every one of them has an opinion. Everything is negotiable.

Buyers new to the game tend to get caught up in the beautiful buildings, the impressive fleet of cars and the large amount of funded preneed contracts, which represent future business for the buyer. Unfortunately, many funeral homes are overbuilt and overfurnished to serve what looks to be the predicted revenue streams. Professional cars, especially limousines and funeral coaches, are also being used less and less. But buyers as well as sellers insist these items will add significant value to the business. Kind of, but not exactly. While these are all important components, the most important piece of the puzzle is the cash flow of the business. Buyers need to be aware they are purchasing the future cash flows of the business based on the historic cash flows. By understanding this, a buyer already is pointed in the right direction and is a step ahead of most that have considered buying their own business.

The value of the funeral home is determined by its financial statements, which are most definitely supported by tax returns. Buyers should have these financial statements and tax returns closely examined by their adviser. Ask questions. Perform due diligence like

there is no tomorrow. A buyer's livelihood is hanging in the balance. Demand to see a minimum of five years of tax returns. Don't rely solely on spreadsheets and pie charts that were put together by someone working on behalf of the seller. Do not rely on the broker's pro forma showing you how the business is projected to perform under new ownership. Anyone can assemble an impressive presentation folder.

Former President Ronald Reagan explained due diligence better than anyone when he made the statement, "Trust but verify." Though he was referring to how he was planning to handle future negotiations with the former Soviet Union, his statement is excellent advice and applicable to this discussion. If the seller's side refuses to provide any requested documents, especially tax returns, simply pass on the deal. The buyer should run away and not look back. Let this be a problem for someone else.

Moving forward, the buyer needs to closely examine how the deal is being structured. Buyers need to determine what type of entity to form that best fits their tax situation. However, be mindful that tax regulations do change over time, though not often, and what is best today may not be best when it comes time to sell the business many years down the road. Also, making major changes later to the structure would likely trigger a tax bill. Taxes are inevitable and future

owners will be paying plenty, so don't force yourself into paying more than necessary. Start out in the best position possible.

Buyers will have many options to consider when forming their business entity. Those include operating as a sole proprietor, a limited liability company, a partnership, C-corporation or an S-corporation. It should be noted that LLCs can be taxed several different ways. LLCs can be taxed as a sole proprietor (if there is only one member), a partnership (if multiple members), or elect to be taxed as a corporation. Each option provides benefits as well as drawbacks. Not only are they taxed differently while in operation, they are taxed differently when it comes time to sell the business.

Primarily, there are two ways to go about purchasing a business. Both have advantages and disadvantages. Hopefully readers are seeing a consistent pattern that there are always advantages and disadvantages. It's important to see what fits best by doing some homework.

The most common way to buy a business is through an asset purchase. Simply put, this means the buyer is purchasing the assets from the seller and these assets will then be placed in service within the new owner's entity. Commonly, these assets would include the real estate, automobiles, inventory, goodwill, as well as the furniture, fixtures, and equipment. It is normally not advisable

to purchase the accounts receivable of the seller. A key point regarding an asset purchase is that it will provide the buyer with a tax advantage through depreciation. These assets are new to the buyer's entity, allowing depreciation to start fresh. This will give the buyer non-cash deductions that will reduce taxable income and, in turn, reduce the tax liability. If planned correctly, the buyer could create a nice tax shelter in the early years of ownership when the cash flow is most critical. A final key point to know is that in an asset purchase, the buyer assumes none of the seller's liabilities.

For both legal and tax reasons, the real estate likely should not be owned inside the operating entity. This is especially true if the buyer opted to form a C-corporation as these entities face double taxation. Taxpayers normally don't like to be taxed once let alone twice. By holding the real estate outside the operating entity, rent is paid by the funeral home (operating entity) to whatever other entity was formed to own the real estate.

A second, and much less common way to purchase a business, is through a stock purchase. In general, stock purchases are advantageous to the seller because of the favorable capital gain treatment. This reduces the seller's tax liability. Stock deals are more common in cases of selling to key employees or relatives. Only if the business being offered for sale is

taxed as a corporation would a stock sale be an option. If the seller is taxed as either a sole proprietor or a partnership, this would not be an option as there is no stock issued in those types of entities. A stock purchase means just what it says. A buyer purchases the stock of the corporation from the seller. A completely different methodology is used to determine the value of the stock of a corporation. Buyers need to be very careful in these types of transactions, as a stock purchase poses some unique risks.

The most important risk to know is that when a buyer purchases stock, they are also assuming all the liabilities (both known and unknown) of the corporation. The known liabilities are listed on the balance sheet of the corporation – and the buyer can easily calculate how much debt is involved and being assumed. However, an unknown liability could be discovered at some point in the future that was caused by or created by the seller, who is now not liable. Also, bear in mind that depreciation does not start over as it would in an asset purchase. This means there could be no significant tax advantage as there would have been in an asset transaction.

Advantages in stock transactions are that it is an easy process to complete and the buyer could be taking over the corporation with existing assets in place, such as operating capital (cash) and accounts receivable. But often it is

difficult to obtain bank financing for stock transactions. When obtaining financing becomes an issue, the seller could act as the lender and sell the stock over time to the buyer. This would spread the seller's tax liability over time and provide interest income on the loan.

A problem that could interfere with closing the deal on a stock transaction is that banks will often require the owner of a corporation to give a personal guarantee on a loan even though the corporation is the one borrowing the money. Banks do not have a high affinity to risk and may not allow the current owner to be relieved of the personal guarantee that is in place. This is problematic because the current owner (seller) will want to be removed and the existing personal guarantee replaced by one from the buyer who likely does not have a long history with the bank.

Buyers must also insist upon the seller signing a noncompete contract. These agreements vary from state to state and it is important that an attorney who is well-versed in these types of contracts be consulted. Some of the details can be negotiated between the parties, but it is imperative to have one in place to protect your investment.

Hopefully, the information within this article will open the eyes of anyone looking to buy a funeral home. The goal was certainly not to discourage anyone from pursuing their dreams but to

encourage seeking the right advisers, the right lenders and to approach the deal with caution. There are many sources for advice. The adviser's reputation, history or track record within the industry and references are extremely important. Take your time in making decisions on who to hire. The adviser selected will have a direct impact on the chances for survival and a successful future. Often the first question a new buyer will ask is, "How long does this process take?" The timeframe in closing the deal is irrelevant. Care should be taken not to rush into any agreement without knowing for certain if you are buying a business or simply buying a job. No one should be interested in buying a job. There are more funeral home owners that feel they overpaid than ones that feel they bought at a discounted price. Do it correctly from the beginning. Enjoy your rewards during ownership and plan for retirement. Take this advice and you won't have the stress every day of wishing you had. There are many opportunities waiting. 🔑



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