

# Exit Planning for Funeral Home Owners: The Sooner You Begin, The Better!

By Michael Oleksak

With nine out of ten of the 21,000 funeral homes in the U.S. privately or family owned, decisions about succession, control and ownership occur all the time. As the funeral home owner moves into traditional retirement age, options should be evaluated and preparations made early to ensure continuity of business value and transfer of the wealth currently tied up in the business. The sooner you begin the process, the better prepared you'll be financially and emotionally when you decide to transfer ownership.

First and foremost, every owner should have a will in place today and always kept up to date in case of unforeseen events. Stories abound of estates and families devastated by poor preparation and planning.

How do you start the planning process for ownership transfer? First, identify your goals. What do you want to be doing in five years? Do you still want to be involved in the business? Who do you want to own the business after you? How much will you need to live on after transferring

the business's ownership? If you have saved and invested well, you may have more options.

Generally the owner has three courses of action: 1) an external transfer: sell to a third party, either a strategic buyer (corporate entity or competitor), a financial buyer (private equity/rollup) or an individual buyer 2) execute a management buyout to key employees, called an internal transfer or 3) transfer ownership to the next generation of the family via gifting or other forms of share transfer, also an internal transfer.

In all three cases, the future success of the funeral home will depend on maintaining relations with families who have had a good experience using the funeral home in the past; other important relationships are with religious and community leaders and sometimes hospice workers and other care givers who may influence first-time decisions.

Selling to a third party often brings the highest proceeds of any transaction. A sale to an owner already in the industry, called a



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strategic buyer, may yield the highest gross price because of the perceived synergies and cost savings from combining operations that are similar. Some appraisal firms specialize in valuing funeral home real estate, ongoing business, furnishings and equipment to give you an idea of the business value in negotiating a sale to a third party. Owners should be prepared to take "seller paper" (a promissory note from the buyer) to complete the amount of the sale. A good rule of thumb these days in the industry for the total sale amount is: 1/3 cash from buyers, 1/3 bank financing, and 1/3 seller paper.

When considering your options, remember to look at the amount to be retained after the transaction, after deducting

projected taxes and fees. This is especially important if you use professionals like business brokers to sell the business. Have your accountant estimate the expected taxes to be paid. It's not about the sale price—it's about how much you get to keep afterwards.

Private equity groups and corporations may acquire funeral homes in a roll-up plan to combine ownership of many funeral homes. The success of the roll up depends on the ability of the investors' professional management to reduce costs through efficiencies of scale and good management. Rollups are not as active today as the conglomerates are busy integrating the funeral homes into the corporate system.

If the funeral home has experienced and capable management, you could sell to them. This will likely require bank financing for a large part of the payment secured by the assets of the business plus personal guarantees of the managers. The bank loan will be paid out of cash flow from the funeral home operations. As with the sale to the third party, the bank loan will be paid first each month. Any left-over cash flow may then be paid toward the owner's seller note or agreed earn-out based on performance. The total amount for a purchase in a sale to management will likely be less than if sold to a third party.

The risk is that the owner is dependent on the management team's ability to run the business successfully in order to get paid beyond the initial closing amount. The benefit is that the owner may stay involved and on the payroll in some capacity for a smoother transition. The owner could negotiate an extension of payment of certain expenses that had been covered for the owner previously as a financial component of the transaction.

Employee stock ownership plans, or ESOPs, have significant tax advantages for selling owners in some industries but ESOPs also generally have minimum size requirements in terms of revenues or number of employees who must participate. Few funeral homes will meet these minimum size requirements to qualify.

The third option is to transfer ownership to the next generation. If the owner's son/daughter or a combination of relatives have had experience and want to continue the business, this may be an option. Gifting of the shares can be a way of effectively transferring ownership, while the owner maintains voting and operational control to be transferred over time.

Gifting may mean the lowest financial payout to the owner, although the owner can stay on the payroll as an employee and continue to receive salary and benefits. This can be an effective way to minimize tax exposure as

well because the valuation will be lower than if sold to a third party. Gifting will inevitably bring up issues of what is fair to relatives in the next generation. Questions must be asked about who has worked in the business effectively and who is capable of running it profitably for years into the future.

This transition exercise is a good time to take an objective look at the business through the eyes of an acquirer. Find out exactly what acquirers look for when buying a funeral home business, then start taking steps to improve your operation to meet those qualities.

The exit planning process and the demographics of retiring baby boomers mean that there are professionals who now specialize in helping business owners prepare for ownership transition. The earlier the planning process begins, the better chance for a smooth transition and fulfillment of the owner's goals.