Daniel M. Isard

How Tough Can It Be?

Running a profitable cemetery is not the same as running a profitable funeral home.

Dear Dan,
I read your column last month in which you gave advice to a reader who had a chance to buy his competitor. I, too, have recently been solicited by my competitor. However, it is not a funeral home but a cemetery. I was given a price and immediately jumped at the chance! The cemetery has 100 interments a year at $1,500 per interment. My competitor has been competing with me for marker and vault sales, resulting in about 50 fewer vault and marker sales a year for my company, so this opportunity represents another $3,000 in revenue per vault and marker that I can recapture. Furthermore, there are more than 20 acres of land available. With about 1,000 interments an acre, that represents 20,000 grave spaces. The offer is $1,000,000, and I think they must be crazy! My simple math of an inventory of 20,000 graves at $1,500 per grave tells me this is worth almost $30,000,000! The owner is old and must not know what he has here! Besides, how tough can it be to run a cemetery? I can have my kid mow the lawn and use an outside grave digging service. So, I would like your opinion, but I cannot wait to be a future cemeterian!
Signed, Future Cemeterian

Dear FC,
Thanks for your note. Please save this article someplace safe so you can attach it to the rest of the material you will be giving to your bankruptcy attorney next year.

There are two points of contention in your letter, FC. First is your simplistic appraisal of the cemetery. Second is the reference, "How tough can it be to run a cemetery?" There are many more cemeteries in the United States than funeral homes, especially when you count all of the church and family cemeteries. If there are about 22,000 funeral homes, I would guess that there are more than 200,000 cemeteries, and most are run without a profit objective.

FC, I have learned over 30 years that there are three types of cemetery managers:

1.) Not-for-profit entities and municipalities: They operate a cemetery because they kind of have to. We do not want casketed bodies stacking up on the side of the road.

2.) The second group of owners comprises cemetery operating professionals. The mentality of a cemeterian is different from that of a funeral home operator. The cemeterian is focused on sales, while the funeral home operator is focused on service.

3.) Funeral home owners who run a cemetery as if it were a funeral home.

I have appraised more than 800 cemeteries and never have I employed the method you use above. Appraisers have various names for the valuation techniques they employ, and the one you cite, it seems to me, could be referred to as "Future Value of the Present Loss of All of Your Money." The two real methods used by appraisers are "Capitalizing the Excess Earnings" and "Net Present Value of the Net Profit of the Sale of Inventory," both of which require math and logic skills.

Allow me to start with an explanation of the second method (Net Present Value of the Net Profit of the Sale of Inventory), breaking the name of the method into its parts so you can understand the actions needed to reach a conclusion of value. "Net present value" is a mathematical equation that reduces an income stream to a lump sum. For example, if I am going to pay you $1 a year for 10 years, the "future value" is $10, but the net present value is something less, based on the discounted interest rate. For example, at a 10 percent discount, the 10 payments of $1 have a net present value of only $6.14! The appraiser discounts that income stream by a rate to cover interest and risk of generating the stated goal. The conclusion of value is discounted further by the length of time the income stream will come in. In your case, 100 interments a year with 20,000 possible interments means that it will take 200 years to sell out this cemetery at the current rate of interment. That is a really long time.

The income stream is really the "net profit." This is the net amount after generating revenue, less cost of goods sold and cost of operations. This produces a pretax profit. So, 100 interments at $1,500 each generates about $150,000 in grave inventory sales. Furthermore, the 50 sales of tangible products at about $3,000 each represent additional merchandise revenue of about $150,000, giving this business total revenue of about $300,000. Assuming you mark up the merchandise by 100 percent, the cost of goods sold represents an expense of about $75,000, leaving gross profit at about $225,000.

From the data provided, I cannot determine the costs of operation. I can assume about $100,000 to $150,000 for the labor of operation, insurance, vehicles, equipment and marketing. So at best, the net profit would be between $25,000 and $75,000.

Therefore, how much would you pay to get an income stream of $75,000 on the high end and $25,000 on the low end a year for the next 200 years? Well, that depends on the risk and interest rate. Most investors would realize that this is an actively managed investment and therefore want a rate of return higher than a passively managed investment. They might also look at the factors affecting cemeteries, which include the cremation rate and competition. Therefore, the risk of collecting this money is greater than a normal investment, so I would guess the rate of discount could be in the 25 percent range today.

So, for all of my math scholars, it's time for the formula: *$75,000 to 200 years^25% = $300,000 value.* If the income stream is on the low end of $25,000 a year, that makes the investment worth only $100,000!

The other way of computing value is utilizing the "capitalizing the excess earnings" method. This is similar to a funeral home valuation. Therefore, the goodwill of a funeral home that generates about $75,000 of earnings would also be about $300,000 at the risk rate of 25 percent. That makes sense. If a funeral home wanted to finance the goodwill purchase of $300,000, it would pay a lender about $45,000 per year. That funeral home could afford to pay $45,000 if it had earnings of $75,000. So, FC, the highest value I can guess from the limited data would be $300,000, not $1,000,000 and certainly not the $30,000,000 you were hoping for. Frankly, I think you might be watching too many episodes of *Antiques Roadshow.*

Warning! The value could be even less, even "black hole deep" less. Cemeteries often have perpetual care, a fund into which the cemetery deposits money based on some state-prescribed formula. It is intended to create a large enough depository account so that when the cemetery is fully subscribed, the trust will have enough principal to generate income to cover the costs of operation in perpetuity.

However, if you believe in perpetual care, you probably also believe in the tooth fairy and a world in which unicorns run wild. Each state has enacted laws for the funding of perpetual care. These formulas were created by bureaucrats with the same DNA as those who came up with the funding/benefit formula for Social Security. What might be a correct amount when you are earning 5 percent interest is grossly underfunded when earning 1 percent interest.

When buying a cemetery, you must research the perpetual care trust and, at the very least, make certain it is funded to the state-required minimum. Many are not. If you purchase a cemetery with an underfunded perpetual care trust, it is now your responsibility to make it whole. So the business you thought was an asset will be a liability you will be funding!

Secondly, FC, the premise that a cemetery is easy to run is foolhardy. A cemetery is a sales organization, whereas a funeral home is a service organization. Unless you have an active preneed program, you cannot fathom an active cemetery sales organization. Whereas the typical funeral home sells preneeds equal to between 20 percent and 40 percent of its annual calls, a cemetery should be selling 200 percent more than its annual interments.

Another huge difference between funeral homes and cemeteries is their accounts receivable. A well-run funeral home has A/R equal to about 42 days of sales (or 11 percent of revenue). A well-run cemetery should have A/R of more than 100 percent of annual interment revenue. However, the difference is that the cemetery has no A/R for at-need interment! If a family has an interment and cannot afford to pay for the grave and opening/closing costs, then nothing happens. A funeral home, however, will often put this on its cash advances, pay the bill and hope to be paid back. Cemeterians have a different mindset.

So, FC, just as the article you read in May highlighted that valuation and operation of the possible acquisition are the critical steps, don't be so imprudent as to think it's not difficult to operate a cemetery.

Operating a cemetery is one thing. Operating it profitably is the objective. ✶

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