

HOW TO VALUE A CEMETERY

In the eyes of consumers cemeteries and funeral homes are in the same industry. With our modern-day influence of "one-stop shopping" consumers like the idea of combination operations. So, it makes it easy for them to see the funeral home and the cemetery as part of one process like a valet and a restaurant.

Cemeteries are typically owned by three groups of personalities;

- Nonprofit organizations
- Cemeterians
- Funeral directors thinking that their cemeterians

A cemetery is a business like any other. Therefore the valuation is done like any other business. The problem is like other businesses, accountants often mis-categorize items of the Profit & Loss statement or items of the Balance Sheet. If you break a cemetery down into its simplest component, it is an inventory reduction business. You buy land by the acre, enhance its value with some perceived improvements, and sell it by the square foot.

While there are certainly service components to a cemetery (maintenance, mowing, irrigation, and security) the difference between the mentality of the three groups stated above is how they see their *selling activities*. And this one difference greatly influences the valuation of the cemetery business.

Nonprofit organizations will typically layout their graves to be 48 inches or 60 inches wide by anywhere from nine feet or ten feet in length. They typically will have wider roadways. The pricing for lot/interment rights as well as the essential opening and closings will have no basis in the reality compared to their cost of operations. Nonprofits will often be an at-need oriented cemetery. Their sales will come at the time of death or in advance in for dealing with an imminent death, and advance sales will be on a consumer request only basis. The Non-Profit management will reserve space in adjoining graves if people ask them, without selling the adjoining lot today. Operating for a profit is not the objective of the classic Non-Profit organization. However, some newly designed cemeteries, run by non-profits, are funding their other projects, and therefore this enterprise will be run more assertively.

Cemeteries run by cemeterians will have a profit motive. As they designed their sellable inventory the first thing you typically notice is their grave spaces are going to be narrower. The Cemeterian has a paradigm of operation which will have an emphasis on advanced sales. The internal roads will be narrower as that road is built on inventory. The pricing model will be based upon whatever

the market will bear. No one will be allowed to reserve a space without buying that lot. They change their prices on their remaining inventory frequently. Cemeterians have very strong business backgrounds. They have an emphasis on advance sales. And if I am going to be totally honest, the Cemeterian running a cemetery has a lesser degree of emphasis on service. There is often a conflict here, as funeral directors get phone calls from families complaining about the removal of flowers or other upkeep issues, and the Cemeterian doesn't want to change their ways.

Funeral directors that buy cemeteries do so for various reasons. One reason obviously is because, "*the grass is always greener in a cemetery than the funeral home parking lot*". Funeral directors see the owners of the cemeteries working very few hours a day compared to their own 168 hour per week existence. They look at their own receivables and envy knowing that the cemetery gets paid cash up front.

Funeral directors in many states are allowed to own cemeteries. And they secretly lust in doing so. Only a few states do not allow this for some reason. Usually the reason is explained to be in consumer protection, but it is often an isolationist business mentality by the funeral directors afraid of losing business to the cemeteries.

Cemeteries that funeral directors own may have wide graves or narrow depending upon the layout by the previous owner. Whatever it was, the funeral director who now owns a cemetery is going to be keeping. However prices for lots as well as opening and closing's are going to be changed infrequently. Prices may be changed only once a year. I've seen some cemeteries owned by funeral directors where the prices have been changed once a decade. I have seen a few give away their graves, with any funeral. Yikes!

If the cemetery has a history of advanced sales marketing, the funeral director/cemeterian will continue to have advance sales. However the sales will invariably drop-off, because the funeral director is a nice guy. Cemeterians are tough. When these tough guys set quotas for their salespeople, they are not against firing someone for missing quotas. Funeral directors believe turnover is bad so it is not uncommon to ultimately find the sales person getting a salary for doing nothing. Typically, when funeral directors own cemeteries, the service to the cemetery is impeccable. Here's why: funeral directors are service driven creatures.

Exhibit Cemetery Balance Sheet Assets

APPRAISAL FOR	Eternal Rest Stop
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APPENDIX A

Accountant's Balance Sheet information
accurate as of

31-Dec-02

ASSETS	Accountant's Balance Sheet	Adjustments	Economic Balance Sheet
Current assets:			
Cash	\$50,000	\$0	\$50,000
Accounts receivables - trade	\$1,000,000	\$0	\$1,000,000
Accounts receivables - mortuaries	\$6,000	\$0	\$6,000
Accounts receivables - emp/other	\$30,000	\$0	\$30,000
Inventory - Maus lettering and Numbering	\$25,000	\$0	\$25,000
Inventory - unsold graves	\$100,000	(\$100,000)	\$0
Inventory - Mausoleum	\$200,000	(\$200,000)	\$0
Inventory - unsold crypts	\$5,000	(\$5,000)	\$0
Inventory - other	\$0	\$0	\$0
Prepaid Expenses	\$0	\$0	\$0
Reserve for Bad Debt	(\$100,000)	\$100,000	\$0
Total current assets	\$1,316,000	(\$205,000)	\$1,111,000
Fixed Assets:			
Land development in progress	\$500,000	(\$500,000)	\$0
Buildings and improvements	\$400,000	\$0	\$400,000
Equipment/furniture	\$300,000	(\$225,000)	\$75,000
Land/ acreage	\$750,000	(\$750,000)	\$0
Land Improvements	\$500,000	(\$500,000)	\$0
Total fixed assets	\$2,450,000	(\$1,975,000)	\$475,000
<i>Less depreciation</i>	\$750,000	(\$750,000)	\$0
Net fixed assets	\$3,200,000	(\$2,725,000)	\$475,000
Other assets:			
Goodwill	\$0	\$0	\$0
Notes receivable - Officers	\$0	\$0	\$0
Unexpired Insurance	\$1,000	\$0	\$1,000
Miscellaneous	\$0	\$0	\$0
Miscellaneous	\$0	\$0	\$0
Total other assets	\$1,000	\$0	\$1,000

Total Assets	\$4,517,000	(\$2,930,000)	\$1,587,000
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So therefore how do you value a cemetery? First of all, as in any valuation you want to have the balance sheet be accurate. Look at the above Exhibit of Assets.

The most common misunderstanding is on "Receivables". Funeral directors are not good at collecting receivables but they know not to let them be more than 60 days of sales. Cemeterians allow receivables for advanced sales. However, the balance due must be paid off before any opening or closing takes place. A well run cemetery has good receivables equal to a year of sales! Funeral directors will extend credit on at need services, cemeterians won't get out of bed until the check clears.

Another balance sheet mistake is the phrase "Inventory". A cemetery is nothing but inventory. The land no longer has "land" value once it is consecrated as a cemetery. Liabilities of a cemetery have to be known as well. To be in the cemetery business managers must sell lots. These lots are really interment rights. The interment rights can be below ground single depth, below ground double depth, below ground with a room for a casket or an urn, or aboveground with room for a casket or an urn. So inventory does not exist for valuation purposes, but does for accounting purposes.

Land and buildings must be reduced to their value, but land that is single use, is now inventory. Therefore, its value is shown in the calculation of "goodwill". As to buildings, we keep them on the balance sheet at the cost basis, less depreciation. The building has a value as a single use building. This is not like an airport terminal that can house a restaurant. This building is only used for cemetery purposes.

Exhibit Cemetery Balance Sheet Liabilities

LIABILITIES	Accountant's		Economic
	Balance Sheet Adjustments		Balance Sheet
Current liabilities:			
Current portion of long term debt	\$50,000	\$0	\$50,000
Accounts payable	\$40,000	\$0	\$40,000
Accounts payable - endowment care	\$100,000	\$0	\$100,000
Accrued payroll	\$0	\$0	\$0
Accrued taxes	\$15,000	\$0	\$15,000
Deferred income taxes	\$0	\$0	\$0
Pension Fund Payable	\$0	\$0	\$0
Preneed	\$0	\$0	\$0
Misc.	\$0	\$0	\$0
Total current liabilities	\$205,000	\$0	\$205,000
Long term liabilities:			
Note payable--Local Bank	\$500,000	\$0	\$500,000
Capital lease (automobiles)	\$0	\$0	\$0
Capital lease (postage equipment)	\$0	\$0	\$0
Mortgages	\$0	\$0	\$0
Future Construction Costs	\$0	\$500,000	\$500,000
Misc 2	\$0	\$0	\$0
<i>less current maturities</i>	(<i>\$50,000</i>)	\$0	(<i>\$50,000</i>)
TOTAL LONG TERM	\$450,000	\$500,000	\$950,000
TOTAL LIABILITIES	\$655,000	\$500,000	\$1,155,000
NET OF ASSETS AND LIABILITIES	\$3,862,000	(<i>\$3,430,000</i>)	\$432,000

Liabilities are an issue as well. Look at the above Exhibit, which is the second part of the balance sheet. Cemeteries have a breakdown on current liabilities and long term liabilities. But it's not what is on the books that could be a problem. It is what is not on the books. Remember, the books are written in "accountant-ese".

It's not unusual for cemeteries to pre-sell their future development. Cemeteries will post a picture of an architect's rendering of a columbaria or mausoleum. They will begin selling this in advance of construction. Of course the price will be a little bit lower, but you haven't undertaken the expense of building the structure. At some point you'll see that the idea is being accepted by your community and then you can begin paying for the structure. Initially you may

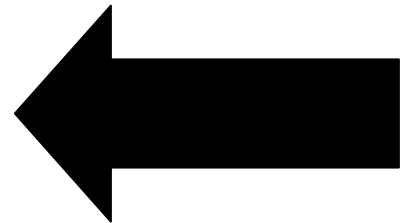
have to deposit a large percentage of the advanced sales but you are essentially prefunding your construction cost. However if you sell this business before you construct a columbaria or mausoleum, this is a liability. We saw a lot of this in the Loewen divestitures before they came out of bankruptcy. So the first phase of valuing a cemetery is to normalize the balance sheet.



Cemeteries do have one hidden liability that funeral homes don't have. That is their Perpetual Care fund. A Perpetual Care fund is established to guarantee the local government that when a cemetery no longer is in the active trade or business of selling new graves, there will be money coming in to cover the care and

maintenance of this acreage. Obviously during the lifecycle of the business is perpetual care income can be used to supplement the overhead needs of the operator (subject to state law). But perpetual care funds are often negotiated through state laws. They have no basis in reality. And just conforming to local law will keep you out of jail, they may not guarantee that there will be sufficient funds, at interest, to provide the passive income needed to maintain the property in perpetuity. Therefore you need to be prepared to do a perpetual care fund analysis to guarantee that he did not have a potential liability. It is not uncommon for cemeterians to over fund their endowment for perpetual care funds.

Cemeteries sell interment rights. The last payment of this interment right is the perpetual care payment. It needs to be paid before the deed for the interment right is granted. The cemetery needs to deposit these payments. Are they deposited as sold, saved up each month, paid once a year, -or- they paid when the Cemeterian gets around. It is not uncommon to find the payments are in arrears. This is a point for due diligence of the valuator, or the buyer.



are to it.

Exhibit Cemetery Revenue Operations

<u>OPERATIONAL HISTORY</u>					
FOR THE APPRAISAL OF:					
Eternal Rest Stop					
	2002	%	2001	%	2000
	\$ Amount	increase	\$ Amount	increase	\$ Amount
Sales	455		458		365
Interments	300		285		265
Average Rev per sale	\$3,187		\$2,620		\$2,740

Revenue net of Cancellations	\$1,450,000	121%	\$1,200,000	120%	\$1,000,000
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The second phase of valuing a cemetery is to look at the historical revenue and expenses. Prior to the Internal Revenue Service issuing Notice 2001-74, cemeteries were on the accrual basis. They were deemed to be selling their inventory and after the 1986 tax change, dealers in inventory could not recognize sales under the installment basis. Public companies liked the accrual method of accounting for many reasons. One by product of this, whether they knew it or not, is it allows them to pump up their revenue with very little effort.

In other words if you send a salesman out and they sell 10 interment rights, three might be paid for in cash and 7 will need installment payment. But for the sake of your books you are going to be recording the gross revenue from 10 sales. We and others found this to be such an accounting problem that ultimately Securities and Exchange Commission mandated a new form of accounting for public companies reporting installment sales, SAB 101. If you are buying a cemetery, you want to know what your actual revenue, on a cash basis, has been.

Some of the sales that were made on the installment method are going to lapse. When the sales lapse, the income recognized in the previous year goes away. So the first thing you need to be able to do in valuing a cemetery is get to handle on the true revenue.

Of course, just as with any other business, the need to understand what your recurring expenses are going to be. Most public companies were very good in reporting their expenses. They did not spend money frivolously. They did not send people on junkets and write it off (at least not at the location's accounting). Privately held cemeteries are fraught with the same "creativity" that we tend to see in privately held funeral homes, or any privately owned business. As we would do in valuing a funeral home, we need to examine the expenses to determine what will be usual and customary and recurring expenses.

Exhibit Cemetery Expenses

	2002	% of sales	2001	% of sales	2000	% of sales
Salaries and Benefits:						
Manager	\$75,000		\$65,000		\$55,000	
Employees	\$400,000		\$350,000		\$320,000	
Benefits & Taxes	<u>\$100,000</u>		<u>\$80,000</u>		<u>\$60,000</u>	
TOTAL	\$575,000	40%	\$495,000	41%	\$435,000	44%
Vehicle Costs:						
Leases	\$0		\$0		\$0	
Operating costs	<u>\$5,000</u>		<u>\$4,500</u>		<u>\$4,500</u>	
TOTAL	\$5,000	0%	\$4,500	0%	\$4,500	0%
Other Cemetery Costs:						
TOTAL	\$7,000	0%	\$3,000	0%	\$2,000	0%
Variable Facility Costs:						
Maintenance	\$50,000		\$40,000		\$45,000	
Utilities	<u>\$38,000</u>		<u>\$36,000</u>		<u>\$35,000</u>	
TOTAL	\$88,000	6%	\$76,000	6%	\$80,000	8%
Advertising: TOTAL	\$60,000	4%	\$55,000	5%	\$50,000	5%
G & A Costs:						
Bad Debt	\$0		\$0		\$0	
Travel	\$3,000		\$2,500		\$3,000	
Promotion and PR	\$15,000		\$14,000		\$12,000	
Legal and Audit	\$4,000		\$3,000		\$3,000	
Telephone	\$10,000		\$9,000		\$8,500	
Office Expense	\$25,000		\$26,000		\$20,000	
Other Tax and Licenses	\$2,500		\$2,500		\$2,500	
Miscellaneous	<u>\$5,000</u>		<u>\$4,500</u>		<u>\$4,000</u>	
TOTAL	\$64,500	4%	\$61,500	5%	\$53,000	5%
Fixed Facility Costs:						
Rent	\$0		\$0		\$0	
Insurance	\$15,000		\$10,000		\$13,000	
Property Taxes	<u>\$15,000</u>		<u>\$14,000</u>		<u>\$14,000</u>	
TOTAL	\$30,000	2%	\$24,000	2%	\$27,000	3%
Operating Income:	\$470,500	32%	\$341,000	28%	\$243,500	24%
Other Costs/Income:						
Non Compete Payments	\$0		\$0		\$0	
Consulting Agreement	\$0		\$0		\$0	
Other Costs(Income)	<u>(\$80,000)</u>		<u>(\$60,000)</u>		<u>(\$50,000)</u>	

	TOTAL (\$80,000)	-6% (\$60,000)	-5% (\$50,000)	-5%
EBITDA	\$550,500	38% \$401,000	33% \$293,500	29%

So, after looking at the history, you want to make a proforma. This will assume the recurring and predictable income, based upon trends, as well as expenses. Let's first look at revenue:

Do not infer any major changes. They are not certainties. If they happen under your management, that goes to your benefit. Be cautious and conservative. You get only 1 shot at it.

Exhibit Proforma Cemetery Revenue

Eternal Rest Stop					
		3 year average		Proforma	
Sales		426		450	
Interments		283		310	
Average Rev per sale	\$	2,856		3,278	\$
Revenue		\$1,216,667		\$1,475,000	
		3 year average	% of Sales	Proforma	% of Sales
Avg Wholesale	\$	309		340	\$
Cost of Goods Sold	\$	<u>131,667</u>	11%	<u>153,000</u>	10%
GROSS PROFIT		\$1,085,000	89%	\$1,322,000	90%

As you look at revenue, you want to be keeping a constant. One cemetery broker who shall remain nameless, and also claims he hasn't bought any of my previous books, but I know has, has the habit of showing a trend line of revenue and then inflating it by about 40%. Their reason is "you can do much better than the current owner". This broker must find some people stupid enough to believe them as they use this to represent future income. If you can do better, it goes to your equity. Also look at the relationship between total sales (this includes at need and advance sales) and interments. As advance sales stabilize, the interments are going to increase, as this "inventory" of future consumers do die.

As to the Cost of Goods Sold (COGS), this is the amortized cost of land, improvements and any merchandise (including markers and vaults) as well as the recovery on niches and mausoleums. Most cemeteries are in the 9% to 11% range. But some new developments or younger cemeteries have higher costs, around 20%. This is because they have new inventory of niches and mausoleums and just haven't gotten to the years when the mark-ups tend to be enormous.

Most cemeteries we consult with, we recommend the 20%-20% pricing strategy. It is a simple concept, but funeral home owners will never understand it. It requires re-pricing on a daily basis practically. Here is the concept.

Set your prices today. Whatever your prices are today, every time you sell 20% of your existing comparable inventory, raise your prices on the balance by 20%. Comparable inventory means similar units. The 3rd level up on a niche is only compared to the 3rd level up niches. A niche that cost you \$100 to build, initially may sell for \$400. So the COGS are at least 25% on that one unit.

But as you sell off 20% of your original inventory, the sale price on that same unit is now going to be changed to \$480. With the cost of goods remaining at \$100, now the cost of goods sold % is going to be down to about 21%.

Sell off 20% of the remaining comparable inventory, and, the sale price is now \$600. The COGS is still \$100, but the % of revenue is now 15%. By the time this unit is the last one on sale in a comparable area, it might sell for \$1,500, and the COGS are now 6%! That is the difference between a young cemetery and a mature one. A mature section of the cemetery should be selling for a lot. And the cost of goods is going to be a small % of revenue. Therefore, if all the other costs are the same, the profit increases dramatically.

Exhibit Proforma Cemetery Operations

	3 year average		Proforma	
Salaries and Benefits: Manager	\$65,000		\$80,000	
Employees	\$356,667		\$420,000	
Benefits & Taxes	<u>\$80,000</u>		<u>\$87,500</u>	
TOTAL	\$501,667	41%	\$587,500	40%
Vehicle Costs: Leases	\$0		\$0	
Operating costs	<u>\$4,667</u>		<u>\$4,000</u>	
TOTAL	<u>\$4,667</u>	0%	<u>\$6,000</u>	0%
Other Cemetery Costs: TOTAL	\$4,000	0%	\$6,000	0%
Variable Facility Costs: Maintenance	\$45,000		\$50,000	
Utilities	<u>\$36,333</u>		<u>\$40,000</u>	
TOTAL	<u>\$81,333</u>	7%	<u>\$90,000</u>	6%
Advertising: TOTAL	\$55,000	5%	\$63,000	4%
G & A Costs: Bad Debt	\$0		\$0	
Travel	\$2,833		\$3,000	
Promotion and PR	\$13,667		\$16,000	
Legal and Audit	\$3,333		\$5,000	
Telephone	\$9,167		\$11,000	
Office Expense	\$23,667		\$27,500	
Other Tax and Licenses	\$2,500		\$3,000	
Miscellaneous	<u>\$4,500</u>		<u>\$5,500</u>	
TOTAL	\$59,667	5%	\$71,000	5%
Fixed Facility Costs: Rent	\$0		\$0	
Insurance	\$12,667		\$16,000	
Property Taxes	<u>\$14,333</u>		<u>\$16,000</u>	
TOTAL	\$27,000	2%	\$32,000	2%
Operating Income:	\$351,667	29%	\$466,500	32%
Other Costs/Income:				
Non Compete Payments	\$0		\$0	
Consulting Agreement	\$0		\$0	
Other Costs(Income)	<u>(\$63,333)</u>		<u>(\$84,000)</u>	
TOTAL	<u>(\$63,333)</u>	-5%	<u>(\$84,000)</u>	-6%
EBITDA	\$415,000	29%	\$550,500	37%

The proforma is one person's opinion. It is a learned opinion, but an opinion just the same. You just make assumptions about the future based upon the reality of the past.

From the proforma, the goodwill calculation is the same as we would see in a funeral home. We create a pro forma, which yields EBITDA. (My wife has threatened to put EBITDA on my marker, instead of my name) EBITDA is going to be allocated to a return on two items:

- 1) the tangible assets, and
- 2) 2) the balance will be assumed to be the return on the intangible assets.

Where the appraiser earns their money, is calculating what the capitalization rate should be on the EBITDA allocated to the intangible assets. The same process in calculating the capitalization rate for funeral home is done for a cemetery, except the results are widely different. The capitalization rates of a cemetery are going to be consistently lower than capitalization rates for a similarly situated and size funeral home. That's because a cemetery has less risk.

Eternal Rest Stop

ESTIMATE OF GOODWILL VALUE BY "EXCESS EARNINGS" METHOD

<i>Our calculated adjusted net profit before income tax, depreciation and interest is</i>	\$550,500
Therefore the adjusted net profit before income tax in a proforma year should be:	\$550,500
<i>Less profit attributable to return on tangible assets</i>	
<i>Adjusted net tangible assets(APPENDIX A)</i>	\$432,000
<i>Multiplied by a safe rate of return on these assets</i>	5.00%
<i>Equals the profit attributable to these assets only</i>	<u>\$21,600</u>

Cemeteries have less risk because they are in the inventory business. This is inventory that never goes bad. You can see cemeteries that are 200 or 300 years old, and if they are still selling new grave spaces this cemetery is an ongoing concern. The inventory doesn't go bad. Now the inventory may have to be redesigned. It's not uncommon for a cemetery to have more inventory it needs because the community has gone to aboveground interment, or an emphasis on cremation disposition. A 4' X 10' grave can hold one body or be redesigned to be double depth. This same size space can be redesigned to be part of a mausoleum, and suddenly have room for seven interments. Or this same size grave can be converted to an urn graveside holding anywhere from 4 to 40 urns. Or it can be converted to a columbaria holding 200 or more urns. But ultimately the inventory does not go bad.

How can you raise the value of a cemetery once you own it? Sell it off quicker or improve it more. Where funeral directors loath cremation, cemeterians can

market columbaria, indoor or outdoor. They can offer mini-mausoleums for large returns. Offer cenotaphs for sale to line a new walkway. Increase the efficiency of your sales staff. Have fewer cancellations. Offer automatic recurring flower sales. Use the internet to direct market without needing a salesperson. These are simple methods to make the cemetery more profitable.

If upon reading this you decide you want to go out and buy a cemetery, the transaction is very similar to that of a funeral home. As the buyer to do you want to make this an asset purchase. You are going to have a portion of the sale price deferred. Or you can certainly label this deferred payment a covenant not to compete, it is very tough for a former cemetery owner to begin competing with you. While I say it's tough it is certainly not impossible. The purpose of a deferred payment is so that in the event you find that the seller has reached a warranty or any representation to you, you have the right to offset or future payments by the value of these damages.