

# Strategic M&A

## HOW TO ENSURE THAT YOUR NEXT MERGER OR ACQUISITION IS SUCCESSFUL.

BY WENDY RUSSELL WIENER, JIM BREAU AND BILL WILLIAMS



**S**trategic mergers and acquisitions can serve as one of the most significant means of growth for a deathcare business. The nature of merging with a company or absorbing another entity enables business owners to rapidly increase market share, enter new markets and expand product offerings and services, among other benefits. In many cases, a successful M&A deal will provide a business with additional financial security as well.

However, in order to reap the full benefits of an M&A deal and successfully grow, deathcare operators must conduct a comprehensive, detailed analysis of the firm they seek to merge with or acquire, i.e., the target. If you and your team do not conduct thorough due diligence prior to closing the deal, Murphy's Law will find a way to make you pay for that failure.

While mergers and acquisitions are attractive options for deathcare operators, the hard truth is that the overwhelming

majority of deals fail. According to KPMG, one of the Big Four accounting agencies, 83% are unsuccessful. That failure could be due to poor strategic fit, a culture clash, disorganization, compliance issues... the list goes on. Despite this statistic, another survey by Deloitte indicates that the number of M&A deals are expected to increase over the next 12 months.

The deathcare industry certainly has and will continue to play a role in the increase of overall M&A activity. The changes in consumer expectations – whether toward cremation, more creative memorial or celebration services or others – have drawn interest from firms to engage in M&A deals so they can offer a wider line of products and services. An M&A deal can also save or reduce overhead costs by consolidating services, such as preparation and cremation, along with other assets, such as rolling stock.

As your business prepares for 2020 and conducts a review of its strategic plan, the topic of a potential merger or acquisition may emerge, if it hasn't already. To help

the deathcare operator make sound, calculated decisions when considering this type of transaction, we offer multiple insights about M&A deals from perspectives related to legal strategy, trust, investments and records management.

### **WENDY RUSSELL WIENER: LEGAL STRATEGY**

Due diligence must begin with a checklist. Effective transaction counsel experienced in handling deathcare business transactions should supply you with a list of items to address with and receive from your target. Too often, even sophisticated buyers assume they can navigate the due diligence period without guidance. Your own experience in the industry as an operator may not give you the capability to effectively be an acquirer.

In the sidebar (right) are excerpts from my due diligence checklist. While not comprehensive, the checklist includes some of the most important components to address and the reasons why they are so essential to effective due diligence.



### JIM BREAU: TRUST MANAGEMENT AND INVESTMENT STRATEGY

If the target has a preneed program, it either has insurance policies or a preneed trust in place (sometimes there's a little of both). There is probably nothing you can do to change the crediting rate of the insurance policies. A preneed trust, however, is a completely different story. The trust will have service providers, such as

a trustee, recordkeeper and investment manager. Each of these relationships must be reviewed.

Questions you should ask the target's trustee, who is the fiduciary and as such must act in the trust's best interest, include:

- Are there any regulatory issues with the trust?
- Are there any earnings that may be dis-

tributed to the seller before closing?

- Will the trustee ensure that only authorized distributions have occurred?
- Has the trustee completed due diligence on the recordkeeper and investment manager?
- What are the fees?

The recordkeeper is responsible for tracking the contract level values in the

## Notable Components of a Legal Checklist for Due Diligence

### • Target's Ownership Structure

Obtain all corporate documents: articles, bylaws, operating agreement, capitalization agreements, owners lists, etc.

### Special Considerations

Is the target in a state that requires ownership by a certain licensee type, such as a funeral director?

Does the state require a certain type of ownership, such as a corporation or partnership?

### • Target's Litigation and Regulatory History

Obtain all court filings relating to any litigation, complete information on any threatened litigation and all regulatory filings relating to allegations of violations of the relevant practice act(s).

### Special Considerations

Does the application for the change-of-ownership process force the target's disciplinary history onto the new owner? This law differs by state.

Will disciplinary problems at the target result in problems for the new owners, such as liability for undisclosed preneed contracts?

Will disciplinary problems at the target result in lack of goodwill in the community?

### • Target's Established Processes and Procedures

Obtain all written manuals, processes and procedures.

### Special Considerations

Does the target have established processes/procedures that will mesh with the new owner's company or that are not

compliant with current laws/rules?

### • Target's Employment Practices

Obtain information regarding all current employees and employment or contractual arrangements.

### Special Considerations

Will a non-compete agreement be required?

Will employment agreements for prior owners be required? Are those agreements subject to approval by the regulator?

### • Approval for Change-of-Ownership Requirements

Obtain information about the regulatory requirements of the state in which the target operates (they differ greatly between states).

### Special Considerations

Is regulatory approval required

before or after closing? What are the timing requirements and the consequences of failing to obtain approval pursuant to those timelines?

Is approval for stock sale required?

**So, assuming you aren't so overwhelmed by the work it took to ensure your target is worthy of your acquisition, the most important advice I offer is this:** Be sure the person who closes the transaction knows deathcare transactions, as they are unlike any other business transaction. Thorough and effective due diligence ensures that you get what you're paying for and eliminates liabilities for past actions of your target, putting you on the road to maximizing your M&A deal.

trust. Since all assets are pooled together for efficiency, an accounting must be kept of the entire balance, all the earnings and dividends. Questions you should ask the target's recordkeeper:

- What are the initial contract deposits and current values for each participant?
- How quickly are data updated and available?
- What are the fees?

The investment manager has the responsibility of the overall investment pro-

gram in the trust and will determine the asset allocation and control its implementation. Questions you should ask the target's investment manager include:

- Is there an investment policy statement for the trust?
- What is the past performance relative to the appropriate index?
- Are the assets in the trust liquid assets (meaning traded on an exchange)?
- How often are investment reviews performed?

- What are the fees?

The preneed trust is designed to function like a pension. Money is paid in, and one day the money comes out. Whether or not it increases is up to the team above.

Growing your preneed trust should be helpful to the firm's bottom line. It generates current revenue in the form of retainage, and ideally, there is the ability to exceed current pricing in the year the contract is fulfilled.

However, to do so, not only does the trusted amount need to make up for the retainage, it also needs to keep up with inflation. It's important to determine whether the preneed trust is helping to increase or decrease the firm's average revenue per call.

A large overall trust balance doesn't paint a clear picture. You must look at the contract detail the recordkeeper will provide to determine the financial performance of the trust. Today, preneed fulfillment represents up to 50% of a firm's total volume, and it's important to make sure that 50% is at or better than the revenue per call from the at-need side of the business.

#### **BILL WILLIAMS: TRUST ADMINISTRATION AND RECORDS MANAGEMENT**

From our experience serving the death-care industry for more than 40 years, we've found that one of the most overlooked actions within a mergers and acquisitions deal is proper due diligence on the target's financial status and records management.

While strategy at the trust level is critical and will set the foundation for synchronization moving forward, lack of due diligence around a firm's trust accounts and preneed contract records can lead to major disorganization, instability and even compliance issues.

When you or a third party conducts due diligence for the trust accounts prior to the deal, you should begin by requesting the company's annual, quarterly and even monthly trust statements over the last three to five years, along with any history of audits and preneed sales projections. A thorough review of these records will help you determine the overall financial health of the company's trusts, if its meeting its regular trust compliance obligations and if the trustee is properly managing the firm's investment strategy.

Conducting this level of due diligence



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on a firm's records and the administrative and technology resources needed to maintain proper trust accounting will help you fully understand the intellectual property you have at your disposal and what could be inefficient or unnecessary moving forward.

- Does the company own patents/trademarks that could benefit or conflict with your resources?
- Has the company taken the necessary steps to protect those assets?
- With what preneed or perpetual care trust technology does the company operate, how critical and effective is it, and will it benefit you once the deal closes?

By studying the existing resources you will inherit, you are easing and accelerating the transition period for you and your team, setting you up for a higher chance of success.

Proper M&A due diligence also includes conducting a very detailed analysis of all trust-related contracts and commitments. While time consuming, it is extremely important to ensuring your operational and compliance success. This analysis will require a study of all trust agreements, contracts with trustees, investment advisors and so on.

You should thoroughly examine whether the company has maintained the records on each preneed contract, especially if the total number of contracts is high. If records management is poor, you may have trouble determining the exact status of each contract.

- Has the company applied consumer payments, investment income and expenses appropriately to each contract line item?
- Are a substantial number of contracts past due and in default?

Once the acquisition has occurred, reconciling the trusts and the recordkeeping for each preneed contract to maintain regulatory compliance will be your responsibility.

Finally, every deathcare business considering an M&A deal must know if the



firm they are merging with or acquiring has ever suffered a data hack. While less of a problem just a decade ago, it is now one of the biggest risks the deathcare industry faces.

A thorough review of the firm's security measures must be done so you understand how vulnerable it is to a future hack, and whether there is a plan in place for when a hack does happen. Data breaches are becoming less avoidable every day, so all firms must have a strategy in place for how to react when – not if – they become a victim.

### GETTING THE HELP YOU NEED TO ENSURE SUCCESS

When reviewing the intricacies for proper M&A due diligence, you may realize that

the task should be done by an expert who understands the financial and legal landscape of the deathcare industry. While it will require a short-term investment on your part, this professionally conducted due diligence could save you thousands of dollars (and headaches) down the line.

If you're considering an M&A deal, you can contact any of the contributors to this article to gain a stronger sense of the requirements and resources available to help you. ☰

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