

# Out with the Aughts: 'D' is for death

The funeral industry is looking forward to the demise of the Baby Boomers

By Ian McGugan, Financial Post, Vancouver Sun

One day you will die. This is sad. It is also an investment opportunity.

Funeral homes are one of the few businesses that are guaranteed a growing audience for their services, not only over the next decade, but over the next several decades.

As Boomers age, the industry made famous in the television series *Six Feet Under* is emerging from the low-mortality period that a funeral home expert calls "death valley" and entering a period in which customers will become more and more common.

Investors who want a way to profit from the aging of North America should take a look at funeral home companies. These firms have surged since their lows of the spring, but are trading well below their levels of a couple of years ago.

The giant in the field is Service Corp. International of Houston. Smaller players include Stewart Enterprises Inc. of Jefferson, La., Carriage Services Inc. of Houston and Canada's own Arbor Memorial Services Inc. of Toronto.

Death stocks have been largely ignored since the 1990s, when consolidators swept through the industry, buying up funeral homes and cemeteries, and turning funeral chains into unlikely glamour investments.

Back then, eager investors expected death rates to start rising shortly after Y2K as the earliest Boomers entered their mid-50s. Unfortunately for the industry, people stubbornly kept on living. Thanks to improved nutrition, medicine and safety, the expected lifespan of Canadians and Americans has steadily increased from 68 in 1958 to close to 80 today.

Many of the funeral home companies that had borrowed heavily to acquire competitors in the 1990s wound up being acquired themselves. The companies that survived faced an increasingly tough market, as more and more customers began to turn down traditional funerals in favour of much cheaper cremations.

The cremation trend is still firmly in place. While only 3.5% of families chose cremation for their departed in 1960, about 41% are doing so now. The proportion is climbing by about a percentage point every year.

Cremation doesn't have to burn up profits, though. The funeral industry is finding ways to tap into new revenues.

For instance, Keystone North America Inc., a funeral home chain that is in the process of being acquired by Service Corp. International, is expanding into the flower business and offering special services for veterans. It is also selling packages that help grieving families deal with financial and estate-management issues.

The biggest trend of all is a move to rework the traditional funeral as a memory of the departed's life. Many funeral homes are working with professional "celebrants" to deliver memorial ceremonies -- and even cater the events with beer and wine.

One way or another, the funeral industry appears to be largely maintaining its sales even in a brutal economy. "We haven't seen any decline in revenue this year," says Brian Snowdon, president of Arbor Memorial. His firm is building funeral homes and reception centres next to its cemeteries to offer customers added convenience.

If the industry can hold its own against the cremation threat, its future looks promising. Mortality rates rise sharply after 65, so the industry's sales reflect the birth rate from six to eight decades ago. Right now, sales are still being dragged down by the low birth rates of the 1930s and early 1940s. Robin Heppell, a funeral-industry consultant in Victoria, calls this period "death valley."

Over the next couple of decades, as Boomers age, the industry's customer base will swell. Barring a huge breakthrough in medical care, the U.S. Centers for Disease Control estimate that the death rate per thousand people in the United States will jump from eight per thousand now to 9.3 per thousand in 2020 and then to 10.9 per thousand in 2040.

Further consolidation in the funeral industry is only slightly less certain than death. Company owned chains can drive down costs by bulk buying of supplies and by sharing resources from hearses to stationery. To take advantage of these efficiencies, all the major chains are trying to acquire funeral homes, but three-quarters of the industry still remains the territory of mom-and-pop operations.

There are two smart ways to play this consolidation trend. One is to invest in Service Corp., the goliath of the industry and the firm most likely to benefit from economies of scale. It trades for only 1.4 times book value and eight times cash flow. It also offers a 2% dividend yield. Its only drawback? A large amount of debt.

If you don't like debt, Arbor Memorial offers a safer play. The Canadian company has a conservative balance sheet, trades for about 14 times earnings and pays a 1.9% dividend yield. While still controlled by its founding family, the company could one day make a tempting acquisition for a large U.S. chain. Death, after all, is a growing business.

-Ian McGugan is a freelance business journalist who writes for the Financial Post.

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