Funerals Market Investigation

Funeral Directors: Profitability Analysis

20 February 2020

This is one of a series of consultative working papers which will be published during the course of the investigation. This paper should be read alongside the Issues Statement published on 8 April 2019 and other working papers published.

These papers do not form the inquiry group's provisional decision report. The group is carrying forward its information-gathering and analysis work and will proceed to prepare its provisional decision report, which is currently scheduled for publication in April/May 2020, taking into consideration responses to the consultation on the Issues Statement and responses to the working papers as well as other submissions made to us.

Parties wishing to comment on this paper should send their comments to Funerals@cma.gov.uk by 19 March 2020.

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The Competition and Markets Authority has excluded from this published version of the working paper information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂]. [Some numbers have been replaced by a range. These are shown in square brackets.] [Non-sensitive wording is also indicated in square brackets.]

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Introduction and purpose of this paper

1. The purpose of this paper is to set out how we have assessed the profitability of funeral director services and to present the findings from our initial financial and profitability analysis.

2. On 24 July 2019, we published a working paper titled 'Approach to profitability and financial analysis' (the 'profitability approach paper'), setting out in detail our proposed methodological approach to the financial and profitability analysis.

3. We have considered parties' comments on this proposed methodology carefully. In this paper, we explain how we have taken those responses into account in carrying out our analysis of the profitability of funeral director services. However, we have not repeated here the detailed methodological discussion set out in our previous paper. Therefore, we recommend that this working paper is read in conjunction with the profitability approach paper.

4. In performing our analysis, we have considered three groups:

   (a) The three largest funeral director services providers, Co-operative Group Limited ('Co-op'), Dignity Plc ('Dignity') and Funeral Partners Limited ('Funeral Partners') (part of the 'larger' funeral directors' group).

   (b) The next ten largest providers of funeral director services by number of branches (also falling within the 'larger' funeral directors' category), being:

      (i) Central England Co-op;

      (ii) Midcounties Co-op;

      (iii) East of England Co-op;

      (iv) Southern Co-op;

      (v) Lodge Brothers;

      (vi) CPJ Field;

      (vii) Beverley Funerals;

      (viii) William Purves;

      (ix) Alan Greenwood and Sons; and

      (x) A W Lymn.

(c) A sample of 'independent' funeral directors, which comprise small funeral director businesses and sole traders which operate from one or a small number of branches, typically within the same region. These firms are referred to as the 'smaller' funeral directors.

5. The paper is structured as follows:

   (a) first, we set out the scope of our profitability analysis, in terms of our coverage of the market for funeral director services and the time period we have considered;

   (b) second, we describe how we have applied the return on capital employed ('ROCE') methodology in analysing the profitability of the larger funeral directors, taking into account the submissions from parties in response to our profitability approach paper and the information that we have collected;

   (c) third, we show the results of our financial and profitability analysis of the larger funeral directors;

   (d) fourth, we set out the results of our financial analysis of the smaller funeral directors; and

   (e) fifth, we provide some preliminary views on how we interpret the results of our analysis.

6. For the larger firms, we have undertaken ROCE analysis in line with our profitability approach paper. In addition to ROCE, we use economic profits per funeral, as well as economic profits as a percentage of cost-plus in order to make comparisons across the parties.

7. These metrics are dependent on reliable capital employed information which, as Appendix A explains, we have been unable to obtain for the smaller firms. Thus, in analysing the smaller firms, we have compared the 'EBITDARS' margin (earnings before interest, taxation, depreciation, amortisation, rent and staff costs) of firms in order to make comparisons.

Scope of our analysis

8. In the profitability approach paper, we proposed to carry out financial analysis on:

   (a) the three largest providers of funeral director services in the UK, namely Dignity, Co-op and Funeral Partners, which have an estimated combined market share of approximately 29%, based on number of deaths; and

(b) a representative sample of 100 branches in the remaining 71% of the market, which is composed of smaller providers.

9. In terms of the time period for the analysis, we proposed to consider the 2014 to 2018 period, as well as forecast data for 2019.

10. As the scope of our investigation covers the provision of at-need funeral director services, our analysis does not cover the sale of prepaid plans.

11. We received a range of views from parties in response to our profitability approach paper, which we consider below.

Parties' views

Market coverage

12. Dignity told us that it was 'concerned that the proposed market coverage of the analysis is low and risks not being representative.' Dignity said that we propose 'to examine around a third of funeral services providers (by number of funerals) active in the market across the period 2014 to 2019', and that 'even if all were found to be earning profits exceeding cost of capital, this would not constitute a substantial part of the market.'

13. The National Association of Funeral Directors ('NAFD') told us that they were 'concerned at the sample size of 100 funeral director branches.'

14. Funeral Partners expressed concern 'that the extent of the analysis the CMA proposes to undertake in the independent sector is not a representative sample of the remaining market' and that 'the analysis may place undue focus on the minority of the market', which Funeral Partners noted as the large players.

15. In response to the financial questionnaire that we issued to smaller funeral directors, The National Society of Allied and Independent Funeral Directors ('SAIF') told us that 'most IFDs are simply not geared up to respond to such a detailed and forensic financial questionnaire' and noted that they consider 'that using such a financial model of research is highly inappropriate to SMEs across the plethora of IFDs.'

16. SAIF also queried the singular use of the profitability ratio model, noting that it is not easily applied across different models of funeral director firms.

17. In contrast, Dignity noted that 'the CMA has kept its financial requests to the Selected Branches "concise" and has asked for more limited information on capital employed in particular.' It said that 'given the crucial importance of

understanding the independent sector, as it accounts for c.70% of the market overall, it appears inconsistent to not explore their financial performance in-depth.'

18. Dignity said that we 'should consider relevant information on the owner's personal earnings/dividends/assets used in the business if these are to be incorporated fully in the analysis, and on a comparable basis to the three larger corporate groups.'

19. Further, Dignity told us that it is its 'experience in acquiring smaller providers that cost items, in particular owner salary and appropriate overtime pay, must be included in the P&L to understand the economics of the business.'

Timeframe

20. NAFD raised concerns that 'looking at a time period of only 5 years could mean that current estimates of ROCE do not capture the full-life returns and may result in a finding that ROCE is greater than the WACC which is due to these life cycle effects rather than problems with competition.'

21. Dignity told us that it recommends 'that the CMA requests more complete actual data for 2019 in January 2020, together with relevant 2020 forecasts' as 'this will allow the CMA a longer time period of analysis and, as the markets continue to change rapidly, it is critical that the CMA's analysis is up-to-date in any remedies design stage.'

22. Co-op said that 'profitability of the Co-op Funeralcare business has reduced significantly over the period' and that this 'suggests that future profitability may be significantly lower than historical profitability and the conclusions from historic profitability may not be indicative of current market conditions.'

23. Further, Co-op explained that its 'profitability has declined significantly in recent years, predominantly due to (1) an increase in the proportions of Simple funerals and Cremation(s) Without Ceremony ('CWC') sold, and (2) declining volumes and market share.'

24. Lastly, it noted that 'even if the CMA extends the period under consideration to 2020, the average level of profitability would still be heavily weighted towards the period where profits were significantly higher than today, which risks drawing conclusions that do not reflect the current market conditions.'

25. Funeral Partners responded to our profitability approach paper by explaining that its 'strategy of investment in quality means that profitability is deferred, resulting in low profitability in the shorter term.' It 'therefore consider[s] that given [its] 'buy-and-build' investment strategy, coupled with investment in [its]

existing funeral homes, the return has not yet realised and can therefore neither be captured by an analysis of historical data, nor be estimated with sufficient accuracy through forecasts.'

26. Funeral Partners therefore asked that we 'consider Funeral Partners' current position – two years into a five-year investment plan – when interpreting the results from the profitability analysis.'

Prepaid plans

27. NAFD raised concerns that 'the role of pre-paid plans could affect the implications of ROCE estimates.' They said that 'it may be possible that the estimated ROCE will be sensitive to how these plans are accounted for in the calculations.'

CMA approach

28. We have considered the views which have been put to us on market coverage, the timeframe of our analysis and the potential impact of pre-paid plans on our results.

29. First, we considered how we could extend our analysis to cover a greater proportion of the market by both market share and in terms of the types of firms. We decided to extend our information requests to the ten largest firms by branch after the three largest firms. These ten firms are made up of a mix of regional co-operatives and independent firms, with the largest firm operating 132 branches, and the smallest operating 27.[1] Expanding our analysis to include these firms means that our analysis of the larger firms covers 42% of all branches in the market.[2] [3] [4]

30. With regards to the use of the profitability ratio model, as further detailed in the results section and Appendix A, we have used a number of different

[1] Central England Co-op (132); Midcounties Co-op (83); East of England Co-op (65); Southern Co-op (57); Lodge Brothers (41); CPJ Field (39); Beverley Funerals Ltd (36); William Purves (31); Alan Greenwood and Sons (28); A W Lymn (27).
[2] All of these firms have provided us with detailed financial information.
[3] This 42% relates to the larger firms only and does not take into account the additional smaller firms for whom we have performed financial analysis.
[4] Additionally, we note that in 2018: 541,589 deaths were registered in England and Wales (ONS); 58,503 deaths were registered in Scotland (NRS); and, 15,922 deaths were registered in Northern Ireland (NISRA). In total, 616,014 deaths were recorded in the United Kingdom. Based on the number of funerals undertaken by the 13 largest funeral directors for 2018, we have calculated a 37% market coverage based on volume of funerals. We note that this is approximate, as the volume figures provided by the firms are based on financial and not calendar years.

metrics of profitability in order to make comparisons across both the larger and smaller firms.

31. In terms of the timeframe of our analysis, we consider that five years is a sufficient period over which to understand the profitability of funeral directors. However, we agree that it would be helpful to include information on the most recent performance of the firms in the industry and propose to collect data for 2019 and future forecasts for the 13 larger funeral directors and update our analysis in due course.

32. With regards to prepaid funeral plans, in calculating capital employed for ROCE purposes, we have excluded any assets or liabilities noted as being related to pre-paid funeral plans.

ROCE Analysis

Approach to ROCE analysis

33. We set out the overarching conceptual approach to return on capital employed ('ROCE') in our profitability approach paper.

34. ROCE is calculated as earnings before interest and tax ('EBIT') as a percentage of the capital employed by funeral directors to provide funeral director services.

35. As set out in paragraphs 32 to 50 of the profitability approach paper, we are guided by the following key principles in carrying out our analysis:

   (a) Return on capital employed compared with the weighted average cost of capital ('WACC') is our primary means of measuring profitability.[5]

   (b) We determine the ROCE using operating profits and net operating capital employed. The general principle is that all revenues, costs, assets and liabilities necessarily arising from the operation of the business to supply the in-scope activities (ie the provision of funeral director services) should be included. We exclude financing costs, and taxation on income and any associated corporation tax or deferred tax.

[5] We use return on capital employed ('ROCE'), where data permits, as this can be computed annually and thus provides greater insights into trends over time and the drivers of profits above the 'normal' level. In addition to using the ROCE framework, we also consider it relevant to calculate economic profits and economic profits/cost-plus as alternative points of comparison across firms which may have different capital structures. Fundamentally, these represent the same approach but allow data to be presented in different ways.

(c) We start with accounting profits and the balance sheets for the operating units of the firms that undertake the relevant activities, and then make adjustments to arrive at an economically meaningful measure of profitability.

(d) We also require common cost and asset allocations where a firm undertakes other business activities in addition to those which we are reviewing in the market investigation.

36. As noted in the profitability approach paper, the value of assets in the capital employed input should reflect their current value to the business ('VTB'). Modern equivalent asset value ('MEAV') is the most common outcome of a VTB assessment. This is the replacement cost of the asset in its current condition today.

37. We have assessed the financial information provided by the funeral director businesses that are within the scope of our analysis and considered the submissions we have received (predominantly from the three largest funeral directors) on the adjustments necessary to update the firms' financial information to reflect replacement cost.

Identification and valuation of capital employed

38. This section of the paper sets out our approach to: (1) identification of the operating capital employed required to provide funeral director services and (2) valuation of those assets.

39. The main categories of assets recorded on the balance sheets of the funeral director businesses are:

(a) tangible fixed assets, such as properties, refurbishment/fit-outs, mortuaries, refrigerators, and vehicles;

(b) intangible fixed assets, such as goodwill, brand/trade names, and software;

(c) working capital, which comprises operating current assets such as inventory, trade debtors, other debtors and VAT, and operating current liabilities such as trade creditors and other creditors;

(d) other current assets such as cash; and

(e) other current liabilities such as intercompany balances.

40. In this section, we consider each of these categories of assets in turn and set out the approach that we have taken in recognition and valuation of these assets in our analysis.

Tangible fixed assets

41. The tangible fixed assets related to the provision of funeral director services are typically properties, refurbishments/fit-outs, mortuaries, refrigerators and vehicles.

42. These assets tend to be valued on the balance sheet at historic cost less any depreciation charged against the asset over its useful life. We asked the three largest firms questions to inform our understanding of the cost of replacing these assets. In particular, we asked them whether:

   (a) net book value ('NBV') was a good approximation for the cost of replacing (owned) material assets in the Historical Period; and

   (b) rental payments on material assets in the Historical Period were in line with market rates.

43. In response, the parties identified the asset categories that they deemed to be material, and then went on to provide views on the appropriateness of NBVs, rental payments etc, as proxies for replacement cost.

44. All three of the largest funeral director firms noted two material asset categories: buildings and vehicles. We first consider these two fixed asset categories, which the parties consider to be material, and then turn to the remaining fixed asset categories.

Properties – owned

45. The first asset category we consider is that of those properties which are deemed as owned. These properties are either owned or held under a long-term ('finance') lease.

46. Co-op told us that properties are measured at cost less accumulated depreciation or impairment losses. It said that given that freehold buildings have relatively long, useful economic asset lives, many of them are likely to have been purchased a long time ago when property prices were different from what the market offers today. Co-op therefore considered that NBV was

unlikely to be an appropriate approximation of the cost of replacing the property today.[6]

47. Similarly, Dignity stated that NBV would ‘not be sufficient to allow [it] to replace the network of funeral homes and supporting infrastructure to the standard of the existing portfolio.’ Dignity noted that it accounts for its physical assets at historic acquisition costs, and inflation in the costs of physical assets – land, buildings, and fleet – means that the depreciated historic cost values in the fixed asset register (‘FAR’) would not cover the cost of replacing the assets today.

48. Dignity noted that significant investment would be needed to replace the physical infrastructure supporting over 840 funeral homes, the mortuaries and the coffin factory. Dignity said that, in its experience, fitting out a satellite branch typically incurs expenditure of c.£ [✄]. It said that ‘for a full-service branch, the fit out alone would be significantly higher in addition to the losses incurred during the ramp-up phase of the branch. Assuming the lower bound of around £[✄] per branch, the costs of replacing the portfolio of over 840 funeral homes would exceed £[✄] million.’

49. We note that Co-op and Dignity have pointed out that where assets are long-lived and have been recorded at historic cost in accounting records, the carrying value of the assets is unlikely to reflect MEAV. Furthermore, we note that properties are the single largest tangible asset category for these firms, such that inaccurate valuation of these assets could materially distort our analysis. Therefore, we agree that the most accurate approach is to revalue owned properties.

50. In contrast, Funeral Partners explained that it only periodically holds freehold buildings. The business prefers to use buildings under operating lease. When buildings are acquired through acquisition of another business, these are disposed of through a sale and leaseback agreement.

51. Funeral Partners noted that when these transactions occur, ‘the values are broadly in line with the values of the assets as held on the balance sheet.’

52. We requested data from Funeral Partners to identify individual owned property assets. We noted that the number of properties owned by Funeral Partners at the year-end date in the Historical Period ranges from 0 to 9. These owned properties tend to be disposed of within 1 to 3 years.

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[6] Co-op explained that they compared gross book values of a number of properties with the estimates of costs of replacing them based on insurance valuations to consider this point. Their results showed insurance values ranging from 1.8 to 5.1 times higher than gross book value.

53. As such, where a firm leases its properties, or owned properties have recently been acquired, we do not believe that revaluation of the property portfolio is required.

54. We have detailed our approach to revaluing the property portfolio of the firms in the 'approach to property revaluation' section below, at paragraph 113.

Properties – rented

55. Not all properties used by the parties are owned or treated as owned (ie held under a finance lease). The parties rent many of their properties under short-term (ie 'operating') leases. Rented properties held under operating leases are not currently recorded on the balance sheet, and therefore are not included within capital employed. While capital employed is therefore lower than it would be if the leased properties were held on the balance sheet, EBIT is also lower due to rental payments.

56. Dignity responded to our profitability approach paper by saying that 'Dignity agrees with the need to capitalise leases, and to do so across the relevant period and the providers in the CMA's analysis.' It said that 'as the CMA is, in particular, seeking to understand forward-looking profitability, where capitalisation of leases under IFRS 16 is required, it is necessary to conduct the analysis in the relevant period on a consistent basis.'

57. In terms of whether rental payments in the Historical Period were in line with market rates, Co-op stated that leasing arrangements are structured such that premises are leased from individual landlords in the open market, with three levels of rent review at the start, during, and at the end of the lease term. Co-op therefore regards rental payments to be in line with market rates.

58. Dignity noted that property rentals are from third-party landlords and its rates would reflect market conditions in each location. Dignity also stated that it conducts regular rent reviews and negotiations. Therefore, Dignity consider rental payments to be in line with market rates.

59. Funeral Partners told us that it considers rental payments to be in line with market rates 'in the main'. It noted that operating leases are undertaken on an arm's-length basis with rental payments reflective of underlying market conditions. Additionally, rent reviews are in place and it is noted that 'many of the lease terms have been renegotiated after initially being acquired as part [of] business acquisitions.'

60. With rental payments considered by the three largest funeral director firms to be in line with market rates, we concluded that it was not necessary to adjust rental costs when carrying out our analysis.

61. We note that as of 1 January 2019, IFRS 16 came into effect, changing the methods used to record operating leases.[7] The impact of these changes will be reflected in the annual accounts published by Dignity and Co-op for the year to the end of December 2019. We do not expect this to have an impact on any of the other parties included in our analysis as we believe Dignity and Co-op to be the only parties reporting under IFRS.

62. Dignity highlighted the change in accounting standard in response to our profitability approach paper and said that 'approximately 50 per cent of the Group's properties are on lease terms that are currently accounted for as operating leases, but which will result in the recognition of both assets and liabilities under the IFRS 16 standard. [✂].'

63. In the context of this working paper, we note that the new treatment of operating leases can be expected to have an impact on our measures of ROCE but that it should not have a material impact on our estimates of economic profits.[8] We will consider the impact of these changes once we have received information from the parties on the changes in their financial statements.

Vehicles

64. As noted in paragraph 44, the other asset category considered to be material by the firms we asked was vehicles. The parties therefore considered whether the NBV of their vehicle assets was reflective of replacement cost in their current condition.

65. Co-op told us that it assessed the NBV and market value of vehicles in 2018 and concluded that on average the NBV of its fleet is a fair approximation of the cost of replacing it. It said that since there have been no changes in depreciation methodology or significant changes in the market values over the historical period, it has assessed the value of its fleet only in 2018.

66. Co-op explained that the market value estimates used to consider whether NBV is appropriate were based on either:

(a) known sales values from their history of sales; or

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[7] IFRS 16: Leases is the International Financial Reporting Standard used by companies reporting under International Financial Reporting Standards (IFRS) to account for leases. Both Dignity and Co-op report under IFRS therefore will be required to follow the methodology set out in this standard as of 1 January 2019. Funeral Partners report under UK GAAP therefore requirements differ.
[8] Economic profits are the profits left over, after the providers of capital have been paid a market-based return on their investment, which is equal to the capital employed multiplied by the WACC. It is calculated as EBIT less WACC x Capital Employed.

(b) market research of auction and online sale prices, for vehicles of those types and ages that they do not typically sell.

67. From its research, Co-op told us that it found that NBV is higher for vehicles from 1 to 3 years old and lower for older vehicles. Therefore, on average, it considers that the NBV of its fleet is a fair approximation for the cost of replacing it.

68. In contrast, Dignity told us that its fleet of hearses typically comprises new, bespoke-built vehicles. It said that it would be difficult to replace this specification of hearse on the second-hand market. Dignity also said that it tends to purchase batches of hearses to achieve volume-related discounts, which may not be possible to achieve in the more fragmented second-hand market. As such, it told us that it thinks the true replacement cost of the hearses would be significantly higher than the amount recorded on the fixed asset register.

69. Dignity told us that the NBV for the limousine fleet would likely be a more reasonable estimate as there is a more liquid second-hand market in limousines. It told us that a second-hand fleet would not align with Dignity's desired positioning as a quality operator.

70. Funeral Partners told us that the business looks to have 'matched' fleets within local operational areas, and thus sourcing used vehicles in the second-hand market is generally not particularly viable in terms of reaching this goal.

71. However, Funeral Partners told us that where ceremonial vehicles have been placed or sourced in the second-hand market, the values arising on such vehicles have not been out of line with NBV for vehicles of a similar age and condition held by Funeral Partners.

72. We do not agree with Dignity that potential difficulties with replacing an asset (in particular, a bespoke-built hearse) on the second-hand market necessarily makes NBV a poor proxy for depreciated replacement cost, or that discounts for purchasing large volumes should not be reflected in the depreciated replacement cost of its fleet. First, we note that any discounts achieved for bulk purchases can be expected to be generally available in the market and hence reflect the market price of replacing assets. Second, we note that the value of hearses (including bespoke-built hearses), like all vehicles, will decline over time to the point where they no longer have any value. We would expect funeral directors to select an appropriate 'useful economic life' for their assets when applying depreciation to them. Therefore, although the NBV of any given hearse may differ from the value that such a hearse would achieve

in an (illiquid) second hand market, on average across a fleet of hearses, we would expect NBV to proxy the depreciated replacement cost.

73. In addition, we note that both Co-op and Funeral Partners consider that NBV is a reasonable approximation of replacement cost, at least over the whole portfolio of vehicles. Therefore, we do not consider it necessary to revalue the vehicle portfolios of the firms.

Intangible fixed assets

74. In this section we consider intangible fixed assets.

- *Parties' views*

75. Dignity put forward the view that additional intangible assets necessary for the running of the funeral services business are not reflected on its fixed asset register ('FAR'). These include:

(a) the customer relationships and trusted reputation of the funeral homes reflected, in part, in the goodwill and trading name assets on the balance sheet; and

(b) the IT software, systems and know-how that supports the funeral director business, internally developed over time.

76. Funeral Partners emphasised the value of its intangible assets, including brand names and goodwill, to the business. It said that Funeral Partners invests heavily in terms of the businesses and brands which it acquires. It told us that it works to maintain these values as they are a fundamental part of each acquired business and that recognition of intangible assets (in terms of their value, and therefore their inclusion as part of the capital employed in the business) is an important matter.

77. Similarly, Dignity told us that it has pursued a deliberate strategy of growth through acquiring funeral directors with established, trusted local reputations and books of customers. Dignity argued that had it sought to grow customer volumes without acquisitions, it would have devoted and incurred substantially higher customer acquisition costs through the P&L (eg marketing costs, and years of losses during the ramp-up phase of new branches), than it did in fact incur while growing the book through acquisition.

78. Dignity stated that these costs of acquiring customers would have weakened operating profits in the period, but instead are, in effect, reflected in the goodwill and trading names intangibles on the balance sheet.

79. Further, Dignity said that it separately identifies acquired trading names as intangible assets in its accounts (in line with accounting standards). These trading names reflect the value of the reputation of an established funeral director in a local area. Dignity began capitalising acquired trading names in 2004. Therefore, for acquisitions prior to this date, including the management buy-out in 2002, the trading name values would be included in the goodwill figures on the balance sheet.

80. Dignity noted that it considers it would be incorrect, in this case, to exclude goodwill from the capital employed.

81. In terms of software, Dignity told us that it capitalises only some of its software licenses on the balance sheet. Dignity said that its main operating systems were developed internally over several years, and the cost to replace the main IT systems, internally developed software and know-how would be substantially higher than the IT asset reflected on the balance sheet.

82. However, Dignity told us that it does not yet have an estimate of what it would cost to replace the internally-generated IT infrastructure, but it would be substantial.

83. An RFI response submitted by Co-op highlights the importance of former owners in maintaining funeral homes' volumes and profitability following an acquisition, which Co-op told us was consistent with the presence of intangible assets with significant economic value and with the common erosion of the value of an intangible asset when it is transferred from one owner.

- *Our consideration of parties' views*

84. Our Guidelines[9] set the criteria for consideration when determining whether to recognise an intangible asset for the purposes of profitability analysis or not. The Guidelines state that we may consider the inclusion of intangible assets where the following criteria are met:

   (a) It must comprise a cost that has been incurred primarily to obtain earnings in the future.

   (b) This cost must be additional to costs necessarily incurred at the time in running the business.

[9] Guidelines for market investigations, Appendix A, paragraph 14

(c) It must be identifiable in creating an asset separate from any assets arising from the general running of the business.

85. We have noted three main categories of intangible assets recorded on the balance sheets of funeral director firms:

(a) goodwill;

(b) brand/trade names; and

(c) software.

86. We considered whether the parties' submissions gave us reason to believe that there were any additional categories of intangible assets that were reflected in the firms' balance sheets. For example, we considered the potential to include 'books of customers'.

87. We noted that funerals are a one-off purchase with no ongoing contract with the customers. Hence, we do not consider that 'customer books' represent a distinct intangible asset for funeral directors.

88. We consider each of the categories of assets at points (a) to (c) above in turn.

Purchased goodwill

89. Firstly, we consider purchased goodwill. Goodwill arises where a price is paid for a business which exceeds the fair value of tangible assets plus separately identifiable intangible assets.

90. When firms acquire other firms and pay a price in excess of the net assets, they are incurring costs which primarily reflect the value of anticipated future earnings. These costs are additional to those needed to run the business.

91. However, goodwill, by definition, is not an asset that is separable from the running of the business. It is the value of the profits generated from running the business - above those needed to cover costs, including asset costs. Goodwill should not therefore be included in the capital employed because it breaches the third recognition criterion, criterion (c) per paragraph 84.

92. Further, including goodwill is circular when trying to assess whether profits have been above the level needed to cover costs, including asset costs. In extremis, if all future profits were capitalised as goodwill, it would not be

possible to find supernormal profits under a ROCE versus WACC framework.[10] [11]

93. We consider the point raised by Dignity at paragraph 77 above with regards to the additional cost that would have been incurred had growth occurred through expansion rather than acquisition in the section below.

Purchased brand/trade names

94. Per paragraph 77, Dignity noted that additional marketing spend would have been required had it expanded organically as opposed to through acquisition.

95. We consider that when firms either acquire trade names by buying other firms or develop their own trade name, brand or reputation organically, they are incurring costs with the aim of generating earnings in the future. Moreover, we consider it likely that many such costs are additional to the costs incurred in running the business.[12] On this basis, such expenditure meets two out of three of the CMA's criteria for recognition of intangible assets. With respect to the third criteria, ie that the asset created be separable from those assets arising from the general running of the business, we considered that the evidence was less clear. We are not aware of transactions in the funeral director market in which trade names or brands have been acquired without the underlying business also being acquired.

96. In this context, we are not convinced that trade names / brands meet our criteria for recognition per se. However, we found Dignity's argument regarding higher marketing costs in a situation of organic growth persuasive and we considered that a reasonable way to reflect such costs was via the recognition in capital employed as a 'trade name or brand' asset.

97. Next, we considered how to value such a trade name/brand asset. We concluded that we should adopt a cost-based approach, taking care to capitalise only those costs that are additional to those incurred from running the business.

98. In terms of estimating the value of such capital employed, we consider that the most relevant information is the marketing costs incurred in setting up a new branch and building its reputation in a local area, as well as on-going

[10] Because profits would be capitalised into the capital employed based on future cashflows discounted at the WACC. So, capital employed = profits/WACC (the formula for discounting into perpetuity) and therefore ROCE = profit/capital employed = WACC.
[11] The ROCE versus WACC framework is detailed within the profitability approach paper from paragraph 32.
[12] For example, there are certain costs which give rise to brand values that may not be addition to those incurred from the running of the business. For example, consistently providing a good quality service, via well-trained and well-paid staff may give rise to a higher brand value.

costs to maintain a given volume of funerals. We consider this in the following section.

Consideration of marketing spend

99. On the basis of marketing costs incurred in setting up a new branch and building its reputation as well as allowing for continued maintenance costs, we consider it possible to identify the replacement cost of a funeral director's trade name/brand or reputation. This section details the approach we took to doing so.

100. We obtained information from the three largest funeral directors on their marketing spend, both at a company-level and with regards to the opening of new branches.

101. Per our analysis, we calculated an approximate spend of £[✂] on marketing across the first three years of a new branch, which could be seen as investment in establishing the trade name / reputation of the branch in its local area.[13]

102. Next, we considered what the useful economic life of this trade name / reputation asset was and how we should treat the costs of maintaining this asset on an on-going basis. We noted that firms were likely to have to incur on-going marketing and other expenditure in order to avoid the decline of this reputational asset over time. However, we did not have any evidence on which to base our assessment of its useful economic life. Therefore, our initial analysis treats this asset, once acquired, as having an indefinite life, ie the asset is not amortised. However, consistent with that approach, we have also assumed that on-going maintenance expenditure should be expensed (rather than capitalised) in the year in which it is incurred.

103. As a result, we adjusted the firms' financial results in two ways:

(a) Capital employed: we increased capital employed for each firm for each year by the value of £[✂] for each branch operated by the funeral director at the year-end.

(b) EBIT: we recognise that marketing spend will have been incurred by the parties in each of the first three years of opening a new branch.

[13] Co-op provided us with the marketing spend on new branches, detailing the total spend across the first three years of operation. We assessed the average 3-year spend for branches with approximately 3 years of activity and calculated a result of £[✂] per branch. Similarly, we assessed the 3-year marketing spend of Funeral Partners' new branches with 3 years of activity, calculating an average result of £[✂] per branch. Thus, we consider an average of £[✂] to be applicable to all parties. We note that Dignity was unable to provide us with similar information.

Considering the asset has been recognised on the balance sheet per the adjustment at point (a), we have added back £[✂] to EBIT for each year, for each new branch opened in that year. We have also added back the same amount in years 2 and 3 of the branch opening on the assumption that these costs are incurred evenly over the first three years of operation. We note that these cost add-backs have only be applied where branches were opened organically rather than acquired.[14]

104. Further to the above, we considered Dignity's submission on start-up losses as at paragraph 77 above, but note that evidence we have collected from recent independent entry suggests that funeral directors do not necessarily incur operating losses for an extended period when they open, and do not need a high volume of funerals in order to break even.[15] Hence, we do not consider it appropriate to capitalise any such losses as part of a firm's brand, reputation or trade name.

Software

105. We consider the treatment and consideration of software to be the same as it is for tangible assets. This is because software is needed to provide the services in question, and the asset would be needed in a well-functioning market. Further, the cost of replacing software is usually relatively straightforward to establish.

106. As such, we include software, as recorded on the balance sheet, in our calculation of capital employed.

107. We recognise Dignity's point per paragraph 81 above regarding internally developed software. We agree that it may be appropriate to include internally-generated software which is required for the provision of funeral director services but not recognised on the balance sheet due to being created in-house.

108. However, Dignity have not provided us with an estimate of what it would cost to replace their internally developed software. As such, in calculating capital employed we have used the value per the balance sheet.

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[14] Where branches have been acquired, we have included the trade name asset at a value of £8,000 per branch but we have not made any adjustment to EBIT.
[15] For example, [✂] told us that he thinks it possible to set up a funeral director business, including fridge and preparation equipment, with less than £10,000. [✂] explained that when they started their business they did not own or rent premises, rather they used a branded van to both transport the deceased but also to advertise the business. They explained that they used shared mortuary facilities in the absence of having their own premises. Thus, it appears that significant investment is not required to start a funeral director business. [✂] told us that it is possible to break-even while doing only four or five funerals per month.

Working capital and cash

109. Working capital comprises inventory, trade debtors and other debtors and operating current liabilities such as trade creditors and other creditors.

110. These assets are considered necessary for the provision of funeral director services and therefore we have included them in our calculation of capital employed.

111. As noted in paragraph 35(b), financing costs and balances are excluded from the calculation of EBIT and capital employed.

112. We have therefore excluded cash balances from the calculation as this represents a means of funding the capital employed of the business rather than being an operational balance.

Approach to property revaluation

113. The key adjustment we made to the financial information provided to us by the larger funeral directors was therefore the revaluation of their owned (or treated as owned) property portfolio.

114. We consider that the most accurate approach would have been to obtain values relating to the current purchase cost of the properties employed by firms in providing funeral director services.[16] However, we are not able to obtain this information given the large number of properties employed by the parties and the fact that market prices of the properties is not information that the firms would hold.

115. We therefore considered using historic costs, ie what the parties actually paid but, as noted above, where assets were purchased a long time ago, these will differ considerably from current replacement costs.

116. Co-op put forward the idea of using the House Price Index ('HPI') to uplift historic purchase costs.

117. We thought this would be likely to over-value properties purchased historically due to significant growth in UK house prices over the last 50 years. We note that a commercial or retail property price index would be likely to be more accurate. However, at the current time, we have not been able to identify a suitable such index.

[16] As these are generally standard high street units, we would not be worried about profitability of the particular firms affecting purchase prices.

118. Therefore, for our initial analysis, we have followed Co-op's proposed approach of using the HPI but note that this is likely to over-value the property owned by the firms and depress ROCE below its true value as a result. Our method is detailed below.

119. We propose to consider sensitivities to this approach as we develop our analysis further. Co-op also suggested the use of the CPI index in revaluing properties, and our sensitivity analysis will include using the general level of inflation ('CPI') to revalue properties.

120. To revalue properties, first we identified the principal property assets within the parties' property portfolio and the original book value (being the purchase price paid).

121. We excluded capital expenditure associated with the property, ie fixtures and fittings. We expect these assets to have relatively short Useful Economic Lives ('UELs') therefore we do not think the net book value of such assets will materially vary from replacement cost in current condition. As such, we did not revalue these assets.

122. We used the HPI[17] to uplift the core property value for each year of the Historical Period.

123. Next, we considered what UEL to assume for the revalued properties in our analysis. In the information given to us by Co-op, the asset life of all buildings (excluding fixtures and fittings) was shown as 50 years. Dignity provided us with its FAR which showed useful lives for property assets ranging from 0.04 to 60 years. We calculated that approximately [✂]% of the relevant portfolio had a useful life of 50 years.[18] On the basis of this information and observing that a UEL of 50 years is standard for properties, we used this in all instances.

124. We used the revised purchase cost, UEL and asset age to calculate the revised accumulated depreciation. Removing revised accumulated depreciation from the revised purchase price results in the depreciated replacement cost.

125. The original net book value of the revalued properties was removed from calculated capital employed and replaced with the depreciated replacement cost.

[17] The House Price Index (HPI) is a national statistic which shows changes in the value of residential properties in England, Scotland, Wales and Northern Ireland.
[18] CMA calculation.

126. This resulted in an updated capital employed figure which reflected the revalued core property asset. We explain in paragraph 131 below the consequent adjustments made to depreciation in order to ensure consistency between balance sheet and P&L (ie full articulation of the accounts).

Adjustments to EBIT

127. In addition to considering capital employed, we considered the need to make adjustments to EBIT.

128. EBIT is a firms' earnings before interest and tax. Therefore, interest and tax revenues and costs are excluded. We made some additional adjustments to EBIT to ensure we used a figure which was meaningful for profitability purposes. This section details the adjustments we made.

Exceptional items

129. Exceptional items typically occur infrequently or relate to transactions outside of the normal course of business (eg large gains on the sale of property). As such, we do not consider them to be relevant to understanding the underlying profitability of the activity we are seeking to analysis, ie the provision of funeral director services.

130. Approximately £[✄] of exceptional items were excluded from Funeral Partners' EBIT over the five-year period. The exceptional items are almost exclusively costs (rather than income) incurred by the group, that are one-off/non-recurring in nature, and are non-trading related. As such, these costs are excluded from EBIT in order to report a financial result that is reflective of the underlying profitability of the business. No other exceptional items were noted.

Depreciation of property

131. Having revalued owned properties using the HPI, it is also necessary to take into account the corresponding impact on EBIT. There are two elements to this:

(a) as the value of their firms' properties has increased, the depreciation charge thereon will also increase; and

(b) as the properties employed by the firm change in value over the relevant period, the firms make holding gains / losses on these properties.

132. The holding gain (or loss) is calculated as the movement in the depreciated replacement cost of the property from one year to the next. The holding gain

(or loss) is therefore the increase (or decrease) in the replacement cost of the asset during a given period. This is the result of holding the asset only ie not the result of improvements/refurbishments/fit-outs etc.

133. We consider it appropriate that changes in the value of capital employed over the period are recognised in EBIT, including holding gains and losses, to help ensure the analysis is economically meaningful. Therefore, we have removed the depreciation that Dignity and Co-op charged against their property portfolios over the relevant period and replaced this with a total holding gain or loss, which reflects both changes in the HPI and the depreciation of property assets as they age.

134. To ensure that annual trends in financial performance of the funeral director business are not distorted by trends in holding gains or losses, we have calculated the total holding gain (or loss) over the five-year period and allocated this equally to each year.

Larger funeral director profitability results

135. In this section, we detail the metrics of comparability used and present the initial profitability results of the larger funeral director firms. This includes the three largest firms, as well as the next 10 largest firms by branch numbers.

Comparability metrics

136. We have used a variety of metrics in analysing the profitability of the firms, including:

(a) average revenues;

(b) cost-plus; and

(c) ROCE and economic profits.

137. To aid comparability across firms, we have estimated average revenues[19] and average cost-plus per funeral including all disbursements.[20]

[19] For the purposes of profitability analysis, in calculating average revenue per funeral we have used total revenues provided by the party and divided this by the number of funerals performed in the corresponding period. Analysis undertaken in the Funeral Directors Pricing Level and Trends working paper uses a different approach, focusing on revenue by funeral package, thus some small differences occur across the two papers.

[20] We note that some firms earn a margin on some disbursements, whereas others do not. Hence, the simplest approach was to include all disbursements in revenues, with the relevant corresponding costs in Cost of Sales. However, we recognise that this may reduce comparability across firms in other respects.

138. Average revenues have been calculated on a total basis, ie the total revenue earned by the firm (inclusive of disbursements) divided by the number of funerals performed.

139. Cost-plus is the calculation of all costs relevant to funeral director services through the P&L plus the cost of capital (ie the capital employed multiplied by the weighted average cost of capital ('WACC')). This demonstrates the total cost of the provision of funeral services, including an allowance for a reasonable return on capital (debt plus equity).

140. In coming to our estimates of cost-plus, we have ensured that all disbursements are treated on a like-for-like basis across the firms.

141. ROCE has been considered above, from paragraph 33 onwards.

142. Economic profits are the profits left over, after the providers of capital have been paid a market-based return on their investment, which is equal to the capital employed multiplied by the WACC. It is calculated as EBIT less WACC x Capital Employed. This measure of profitability is, therefore, based on the same logical building blocks as ROCE and simply expresses returns above or below the cost of capital in absolute amounts (£).

143. For the purposes of our profitability analysis, we have used a CMA calculated WACC of 8%. Further details around our WACC calculation can be found in our WACC working paper.

144. Economic profits as a percentage of cost-plus demonstrates how much prices have been above the 'normal' or 'competitive' price assuming that the firms' costs have been efficiently incurred. We note that this will not necessarily be the case, ie some firms may be operating with an inefficiently high level of costs. Using these percentages provides another means of understanding the scale of any economic profits and of making comparisons across the larger funeral director firms.

Results tables for larger firms

145. In this section we set out the results of each party in turn, starting with the three largest firms, followed by the next 10 largest firms by branch numbers.[21]

[21] The order in which results are presented in the tables below is not reflective of the lists at paragraph 4. In presenting the results of the larger firms, we have replaced the name of the firm for confidentiality purposes and replaced with 'Firm' followed by a letter (eg Firm A).

Firm A

Table 1: Firm A profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[300–350]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[20–30]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

146. ROCE is above our estimate of the WACC (of 8%) throughout the relevant period, with an average return of [20–30%]. It is materially higher in the first three years before declining through the later period, while remaining above the cost of capital. This equates to economic profits of between £[100–150] and £[450–500] per funeral over the period, ie around [✂]% over Firm A's total cost base, including an appropriate return on capital employed.

147. Firm A sees increases in average revenue per funeral year-on-year until 2018 in which it falls for the first time. Cost-plus, however, increases year-on year. Economic profits are at their highest point in 2015, at £[450–500] per funeral, but by 2018 this has declined to £[100–150] per funeral, with a particularly sharp drop (of more than 50%) between 2017 and 2018.

Firm B

Table 2: Firm B profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[600–650]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[30–40]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

148. Firm B has earned a ROCE significantly above its WACC throughout the relevant period, with an average return of [30–40]%. This equates to economic profits of between £[400–450] and £[700–750] per funeral over the period, ie around [✂]% over Firm B's total cost base, including an appropriate return on capital employed. While Firm B also sees a drop in economic profit per funeral in 2018, the absolute figure remains high. Firm B also sees a fall in ROCE in the last two years of the period, however it remains significantly above the cost of capital.

149. Firm B increased its average revenues year-on-year from 2014 to 2017, before seeing a fall in 2018. Similarly, its cost-plus figures have increased year-on-year.

Firm C

Table 3: Firm C profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[400–450]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[50–60]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

150. The ROCE of Firm C is high and fluctuates significantly across the five-year period (between [30–40]% and [90–100]%). This equates to economic profits between £[200–250] and £[650–700] per funeral over the relevant period. We note that while Firm C's ROCE figures are higher, on average, than those of Firm A and Firm B, this appears to be partly due to the lower levels of capital employed, with its average economic profits per funeral over the period being higher than those of Firm A but lower than those of Firm B.

151. The average revenue per funeral of Firm C is between Firm A and Firm B. However, while Firm A and Firm B see a drop in average revenue per funeral in the later years, this is not the case for Firm C, who have the highest ARF of the three largest firms by 2018. Similarly, cost-plus per funeral increases year-on-year.

152. Considering other metrics of profitability, the trend in economic profit as a percentage of cost-plus follows a pattern which is in line with Firm A and Firm B, ie increasing or steady to 2016 before seeing a downward turn. Firm C's economic profits as a percentage of cost plus, at [✂]% on average, sits between that of Firm A ([✂]%) and Firm B ([✂]%).

CMA commentary

153. The financial performance of the three largest firms exhibits significant similarities, with their average revenues per funeral being within [✂]% of each other, and their total cost plus per funeral being within [✂]% of each other. All firms have earned returns significantly in excess of their cost of capital, demonstrated by their significant economic profits per funeral. Firm B has achieved the highest overall level of profitability as a result of achieving the highest average revenue and the lowest average cost-plus of these three firms.

Firm D

Table 4: Firm D profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[400–450]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[20–30]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

154. Firm D's ROCE is significantly above the cost of capital in all years, averaging [20–30]% over the period, which is consistent with the most recent three years. Economic profits are on average [✂]% of cost-plus, ranging between £[250–300] and £[500–550] per funeral.

155. ARF increases year on year, demonstrating an increase in prices for each year from 2014 to 2018, alongside an increasing cost-plus in all years aside from 2015.

Firm E

Table 5: Firm E profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[250–300]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[60–70]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

156. Firm E sees significant fluctuation in ROCE throughout the period. However, the ROCE remains high and above the cost of capital, ranging between [✂]% and [✂]%. Economic profits average at [✂]% of cost-plus, ranging from £[100–150] to £[350–400] per funeral.

157. Aside from a small decline in 2016, Firm E has increased its average revenue per funeral progressively over the period. The cost-plus figures demonstrate that costs have also been increasing across the same period.

Firm F

Table 6: Firm F profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[300–350]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[10–20]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

158. Firm F earns ROCE in excess of the cost of capital in each year, and economic profits between £[250–300] and £[400–450] resulting in an average EP/CP of [✂]%. Average revenues have increased each year while there has been a similar increase in cost-plus per funeral.

Firm G

Table 7: Firm G profitability results[22]

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[250–300]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[10–20]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis129

159. Firm G earns a ROCE of [10–20]% on average, in excess of the cost of capital. The firm shows economic profits ranging between £[200–250] and £[250–300] per funeral, which are [✂]% of cost-plus, on average. The firm sees increasing ARF year-on-year, with cost-plus also growing.

Firm H

Table 8: Firm H profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[(200–250)]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[0–5]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

160. Firm H's results demonstrate a ROCE lower than the cost of capital, with the firm making material economic losses in every year from 2014 to 2018, with low ROCE results across the period.

161. The firm demonstrates average revenue per funeral figures within the range of the other larger firms but its cost-plus is significantly higher. This suggests that its economic losses may be being made due to cost-base issues as opposed to low revenues.

[22] Note that the results for this party include a small amount of non-funeral director related activities. While we obtained information relating to the amount of revenue this made up, we could not obtain corresponding cost information. Thus, for the sake of consistency, all information has been included.

Firm I

Table 9: Firm I profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[300–350]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[10–20]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

162. ROCE is significantly greater than the cost of capital in the first two years, before seeing a decline in 2016 and falling more in line with the cost of capital in 2017 and 2018. Average ROCE is greater than the cost of capital, at [10–20]%. Economic profits average £[600–650] in the first two years, before dropping to £[0–50] per funeral in 2018. This decline in profitability appears to result from relatively static average revenues per funeral against a backdrop of increases in the cost base. EP/CP averages [✂]%.

163. While cost-plus per funeral has increased year-on-year for Firm I, average revenue has not reflected the same trend. Average revenues peak in 2015 before dropping in 2016 and then remaining reasonably steady.

164. We note a significant decline in funerals per branch from 2014 to 2018. The firm saw a 90% increase in branch numbers over the same period, contributing to the decline in average number of funerals per branch.

Firm J

Table 10: Firm J profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[(0–50)]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[5–10]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

165. Firm J's ROCE is largely in line with the cost of capital, and the firm makes economic losses in four out of the five years, averaging a loss of £[0–50]. EP/CP is in the range of [✂]% to [✂]%, suggesting that the firm is charging prices largely in line with cost-plus.

166. Firm J demonstrates both particularly high average revenues per funeral and particularly high cost-plus per funeral, when compared with other funeral directors.

Firm K

Table 11: Firm K profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[450–500]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[20–30]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

167. Firm K earns ROCE in excess of the cost of capital in all years. The firm sees an increase in economic profit per funeral in each year, averaging £[450–500] per funeral over the relevant period. The EP/CP results show that the firm is charging prices approximately [✂]% greater than cost-plus.

168. ARF has increased over the period, with costs also increasing but at a lower rate which means that economic profits per funeral have approximately doubled.

Firm L

Table 12: Firm L results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[0–50]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[10–20]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

169. In all years apart from 2015, Firm L demonstrates ROCE in line with the cost of capital. As a result, economic profits are around £[✂] in three of the five years, and average £[0 – 50] per funeral over the period as a whole. The firm appears to be charging prices largely in line with cost, with an average EP/CP of [✂]%.

170. Cost-plus per funeral is largely in line with average revenues, which see an increase year-on-year.

Firm M

Table 13: Firm M profitability results

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Average revenue per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Cost-plus per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Economic profit per funeral (£)	[✂]	[✂]	[✂]	[✂]	[✂]	[300–350]
EP/CP (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
ROCE (%)	[✂]	[✂]	[✂]	[✂]	[✂]	[20–30]
Funerals per branch	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis

171. Firm M earns ROCE in excess of the cost of capital in all years, averaging [20–30]%. The firm earns economic profit per funeral of £[300–350] on average, and economic profits as a percentage of cost plus of [✂]%.

172. The firm has increased average revenues per funeral each year over the period. Cost-plus per funeral has also increased in the period at a greater rate than that of ARF.

CMA commentary

173. The results presented above from table 1 to 13 demonstrate that the larger firms, as a group, are making high returns. With a few exceptions, the firms are making strong economic profits and demonstrate substantial returns on capital employed.

174. Ten of the thirteen firms earn ROCE in excess of the 8% cost of capital. Of the firms earning ROCE equal to or lower than the cost of capital, the key driver appears to be relatively high cost bases as opposed to low revenues.

175. Firm A and Firm B undertake a similar number of funerals per branch throughout the five-year period, at around [✂] per branch. Firm C has seen significant movement in branch ownership over the period and has therefore seen significant variation in number of funerals per branch, which has been increasing overall. We note that the other ten larger firms see more variation in the number of funerals undertaken by branch, with one firm completing as many as 141, and another only 49, on average. The results show that there is variation in the number of funerals being undertaken by these larger firms. Further, we see that high returns are being made regardless of the number of funerals per branch.

176. We note that there are significant differences in ARF and cost-plus across these larger firms. We discuss these patterns in more detail from paragraph 216 below.

Smaller funeral director profitability results

177. Next, we present the results of the smaller funeral directors.

178. As set out in Appendix A, we initially sought to collect both profit and loss, and balance sheet information from the smaller funeral directors in order to carry out ROCE analysis. However, we found that the smaller funeral directors were largely unable to provide robust balance sheet information. We have, therefore, examined the profit and loss information provided in order to understand their financial performance both on a stand-alone basis and in-

comparison with the larger funeral directors. We have detailed our approach to data gathering and analysis for the smaller funeral director firms in Appendix A.

179. We observed that the majority of the smaller funeral directors recorded very low salary costs, which we considered was likely to reflect only the costs of employing external staff, while the profits of these businesses reflected both salary for the owner-managers and an element of return on the capital employed in the business. We note that this approach is to be expected since no such distinction between salary and profit is made for unincorporated business for tax purposes with both being treated as 'drawings'.

180. Therefore, our analysis to date has focussed on average revenues per funeral and a measure of operating profit which seeks to control for differences in both capital structure across firms (both larger and smaller funeral directors) and this difference in approach to recording salaries: 'EBITDARS', earnings before interest, tax, depreciation, amortisation, rent and salaries. We have calculated EBITDARS as a percentage of total revenues and on a £-amount per funeral basis.

ARF per funeral

181. We requested total revenues from funeral director services inclusive of disbursements from the firms. The information presented below demonstrates the total revenue provided by each firm divided by the volume of funerals provided in the period to obtain an average revenue per funeral figure.[23]

182. We note that some firms have ARF figures which appear too low to credibly include disbursements. Some firms showed ARFs of less than £2,000 across the period, which we believe to be exclusive of disbursements, and have therefore been excluded from our further analysis.

[23] Where results have not been available from a party for a given year 'n/a' has been indicated. The results are presented from lowest to highest average revenue per funeral across the five-year period. This table presents the results of the 'smaller' funeral directors only and does not include the 'larger' funeral directors whose results have been presented on a party by party basis in the prior section.

Table 14: Average revenue per funeral of smaller firms (£)[24]

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
FD 1	n/a	n/a	2,290	2,381	2,450	2,374
FD 2	2,264	2,191	2,602	2,787	2,769	2,523
FD 3	2,509	2,704	2,712	2,072	2,695	2,539
FD 4	n/a	n/a	n/a	n/a	2,726	2,726
FD 5	2,693	2,913	2,834	2,848	2,609	2,780
FD 6	n/a	n/a	n/a	2,727	3,063	2,895
FD 7	2,801	2,914	3,025	3,113	3,231	3,016
FD 8	2,545	2,932	2,723	3,448	3,658	3,061
FD 9	2,454	2,518	3,590	3,395	3,571	3,106
FD 10	2,745	2,474	3,434	3,574	3,323	3,110
FD 11	2,970	3,035	3,173	3,227	3,500	3,181
FD 12	3,132	3,107	3,205	3,138	3,364	3,189
FD 13	3,267	3,145	3,167	3,129	3,492	3,240
FD 14	3,375	3,064	3,282	3,390	3,288	3,280
FD 15	3,065	3,102	3,374	3,535	3,623	3,340
FD 16	n/a	n/a	n/a	3,292	3,456	3,374
FD 17	3,568	3,065	3,463	3,204	3,639	3,388
FD 18	2,973	3,418	3,654	3,571	3,650	3,453
FD 19	3,318	3,447	3,126	3,544	3,921	3,471
FD 20	3,357	2,869	3,784	3,778	3,702	3,498
FD 21	3,500	3,500	3,500	3,500	3,500	3,500
FD 22	3,005	4,136	2,981	3,342	4,165	3,526
FD 23	3,314	3,428	3,584	3,700	3,690	3,543
FD 24	3,324	3,980	3,402	3,698	3,948	3,670
FD 25	n/a	n/a	n/a	3,374	4,037	3,706
FD 26	3,530	3,694	3,827	3,834	3,932	3,763
FD 27	3,504	3,730	3,816	3,951	3,977	3,796
FD 28	3,708	3,898	3,984	3,999	4,211	3,960
FD 29	3,670	4,613	4,642	3,371	3,839	4,027
FD 30	5,171	3,701	3,612	3,992	n/a	4,119
FD 31	3,970	3,796	4,273	4,442	4,281	4,153
FD 32	4,314	5,235	5,172	4,750	4,262	4,747

Source: CMA analysis

183. The average revenue per funeral figures for the smaller firms demonstrates a very broad range from around £2,375 to £4,750[25], with around half of the firms for which we collected data having lower average revenues per funeral than all of the larger funeral directors (on average across the relevant period). The other half of the firms had average revenues per funeral that were within the range of those of the larger firms, ie none of these firms had higher average revenues per funeral than the most expensive of the larger firms (Firm J).

184. The smaller funeral directors show greater year-on-year volatility in their average revenues per funeral, which may be the result of changing product mix within smaller volumes of funerals.[26]

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[24] The names of the smaller funeral director firms have been removed for confidentiality purposes and replaced with 'FD' followed by a number (eg FD 1). The referencing remains consistent throughout each of the tables disclosing smaller funeral director information, thus 'FD 1' is the same firm in the ARF, EBITDARS per funeral and EBITDARS margin tables.
[25] These figures are quoted excluding the outliers, as discussed in paragraph 182.
[26] Where a firm undertakes smaller volumes, a change in product mix from year to year (ie a change in the packages offered or in the number of simple vs standard funerals undertaken) will have a greater impact on the overall average ARF.

EBITDARS margin

185. We consider earnings before interest, taxation, depreciation, amortisation, rent and staff costs (EBITDARS) expressed as a margin of revenue to present the most accurate measure of operating performance of funeral director firms.

186. Using this metric allows for comparability of smaller funeral directors regardless of financing, capital structure (ie whether they own or rent properties), and the means by which staff are reimbursed (ie through staff costs or dividends).

187. First, we present absolute EBITDARS per funeral for the smaller firms.

Table 15: EBITDARS per funeral (£)

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
FD 1	n/a	n/a	1,473	1,562	1,632	1,556
FD 2	658	747	369	769	1,077	724
FD 3	760	1,274	1,374	879	1,383	1,134
FD 4	n/a	n/a	n/a	n/a	709	709
FD 5	1,739	1,942	1,868	1,840	1,522	1,782
FD 6	n/a	n/a	n/a	1,848	1,625	1,737
FD 7	1,215	1,290	1,368	1,139	1,337	1,270
FD 8	952	1,293	1,094	1,527	1,704	1,314
FD 9	1,052	968	1,947	1,817	1,438	1,444
FD 10	909	880	1,096	826	1,284	999
FD 11	1,016	954	1,097	1,240	1,126	1,086
FD 12	774	807	807	837	875	820
FD 13	633	684	667	823	738	709
FD 14	1,642	1,453	1,526	1,409	1,486	1,503
FD 15	1,425	1,507	1,527	1,688	1,633	1,556
FD 16	n/a	n/a	n/a	1,902	2,120	2,011
FD 17	414	311	516	526	3,639	1,081
FD 18	1,197	1,492	1,620	1,465	1,538	1,462
FD 19	1,416	1,293	1,141	1,239	1,273	1,272
FD 20	1,096	902	1,096	948	1,225	1,053
FD 21	247	312	399	564	317	368
FD 22	919	1,692	572	1,357	1,193	1,147
FD 23	1,855	1,912	1,994	2,063	2,088	1,982
FD 24	n/a	n/a	n/a	n/a	n/a	n/a
FD 25	n/a	n/a	n/a	1,265	1,820	1,542
FD 26	1,024	882	1,104	1,059	728	960
FD 27	2,450	2,611	2,744	2,769	2,667	2,648
FD 28	1,818	1,715	1,876	1,644	1,956	1,802
FD 29	1,672	2,149	1,909	1,326	1,930	1,797
FD 30	1,311	969	958	945	n/a	1,046
FD 31	1,871	1,929	2,272	2,318	1,981	2,074
FD 32	1,286	2,353	2,069	1,611	1,452	1,754

Source: CMA analysis

188. Next, the absolute EBITDARS per funeral figures for the larger firms.

Table 16: EBITDARS per funeral of larger firms (£)

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
Firm A	[✂]	[✂]	[✂]	[✂]	[✂]	[1,500–2,000]
Firm B	[✂]	[✂]	[✂]	[✂]	[✂]	[2,000–2,500]
Firm C	[✂]	[✂]	[✂]	[✂]	[✂]	[2,000–2,500]
Firm D	[✂]	[✂]	[✂]	[✂]	[✂]	[1,000–1,500]
Firm E	[✂]	[✂]	[✂]	[✂]	[✂]	[1,500–2,000]
Firm F	[✂]	[✂]	[✂]	[✂]	[✂]	[1,500–2,000]
Firm G	[✂]	[✂]	[✂]	[✂]	[✂]	[1,500–2,000]
Firm H	[✂]	[✂]	[✂]	[✂]	[✂]	[1,000–1,500]
Firm I	[✂]	[✂]	[✂]	[✂]	[✂]	[1,500–2,000]
Firm J	[✂]	[✂]	[✂]	[✂]	[✂]	[2,000–2,500]
Firm K	[✂]	[✂]	[✂]	[✂]	[✂]	[1,500–2,000]
Firm L	[✂]	[✂]	[✂]	[✂]	[✂]	[1,500–2,000]
Firm M	[✂]	[✂]	[✂]	[✂]	[✂]	[1,500–2,000]

Source: CMA analysis

189. Then, we present EBITDARS margins.

Table 17: EBITDARS margins (%)

	2014	*2015*	*2016*	*2017*	*2018*	*Average*
FD 1	n/a	n/a	64	66	67	66
FD 2	29	34	14	28	39	29
FD 3	30	47	51	42	51	44
FD 4	n/a	n/a	n/a	n/a	n/a	n/a
FD 5	65	67	66	65	58	64
FD 6	n/a	n/a	n/a	68	53	60
FD 7	43	44	45	37	41	42
FD 8	37	44	40	44	47	43
FD 9	43	38	54	54	40	46
FD 10	33	36	32	23	39	32
FD 11	34	31	35	38	32	34
FD 12	25	26	25	27	26	26
FD 13	19	22	21	26	21	22
FD 14	49	47	46	42	45	46
FD 15	47	49	45	48	45	47
FD 16	n/a	n/a	n/a	58	61	60
FD 17	12	10	15	16	n/a	13
FD 18	40	44	44	41	42	42
FD 19	43	38	37	35	32	37
FD 20	33	31	29	25	33	30
FD 21	7	9	11	16	9	11
FD 22	31	41	19	41	29	32
FD 23	56	56	56	56	57	56
FD 24	n/a	n/a	n/a	n/a	n/a	n/a
FD 25	n/a	n/a	n/a	37	45	41
FD 26	29	24	29	28	19	26
FD 27	70	70	72	70	67	70
FD 28	49	44	47	41	46	46
FD 29	46	47	41	39	50	45
FD 30	25	26	27	24	n/a	25
FD 31	47	51	53	52	46	50
FD 32	30	45	40	34	34	37

Source: CMA analysis

190. There is a range in EBITDARS results, with the lowest average EBITDARS figure being 11%, and the highest being 66%. The average EBITDARS margin of the group is 40%.

191. Lastly, we present the EBITDARS margins of the larger firms, for comparability.[27]

[27] When calculating EBITDARS margins for the larger firms, with the intention of comparison to the smaller firms, we have removed the holding gain/(loss) as per the revaluation of properties, as well as the marketing

Table 18: EBITDARS margins of larger firms (%)

	2014	2015	2016	2017	2018	Average
Firm A	[✂]	[✂]	[✂]	[✂]	[✂]	[40–50]
Firm B	[✂]	[✂]	[✂]	[✂]	[✂]	[50–60]
Firm C	[✂]	[✂]	[✂]	[✂]	[✂]	[40–50]
Firm D	[✂]	[✂]	[✂]	[✂]	[✂]	[40–50]
Firm E	[✂]	[✂]	[✂]	[✂]	[✂]	[40–50]
Firm F	[✂]	[✂]	[✂]	[✂]	[✂]	[40–50]
Firm G	[✂]	[✂]	[✂]	[✂]	[✂]	[40–50]
Firm H	[✂]	[✂]	[✂]	[✂]	[✂]	[30–40]
Firm I	[✂]	[✂]	[✂]	[✂]	[✂]	[40–50]
Firm J	[✂]	[✂]	[✂]	[✂]	[✂]	[40–50]
Firm K	[✂]	[✂]	[✂]	[✂]	[✂]	[40–50]
Firm L	[✂]	[✂]	[✂]	[✂]	[✂]	[40–50]
Firm M	[✂]	[✂]	[✂]	[✂]	[✂]	[50–60]

Source: CMA analysis

CMA commentary

192. The larger firms that we have analysed are generally earning EBITDARS margins of between 40% and 50% and, as set out above, these margins have allowed them to make returns that are significantly in excess of their weighted average cost per capital over the period. In absolute terms, these firms are earning EBITDARS per funeral of between £1,500 and £2,500.[28]

193. The smaller firms that we have sampled exhibit a broader range of EBITDARS margins, with seven of the sample earning less than 30%, and seven earning above 50%. Similarly, in absolute terms, the smaller firms are earning a broad range of EBITDARS; between around £700 per funeral and around £2,600 per funeral. On average, the smaller firms are earning a lower EBITDARS per funeral than the larger firms, which is consistent with their lower (on average) average revenues per funeral.

Initial analysis of results

194. In this section, we present some initial analysis of the results, including consideration of what could be driving the ranges and trends, as well as noting points we will continue to assess throughout our investigation. We consider:

(a) Profitability;

(b) Average revenue per funeral; and

adjustment. This is to ensure that the firms are being compared on a like-for-like basis; as no adjustments were made to the information provided by the smaller funeral directors, it is appropriate to compare their margins to the unadjusted results of the larger firms.

[28] The figures quoted in this paragraph exclude Firm H, which is an outlier in terms of its absolute and percentage EBITDARS and which is making economic losses as detailed above.

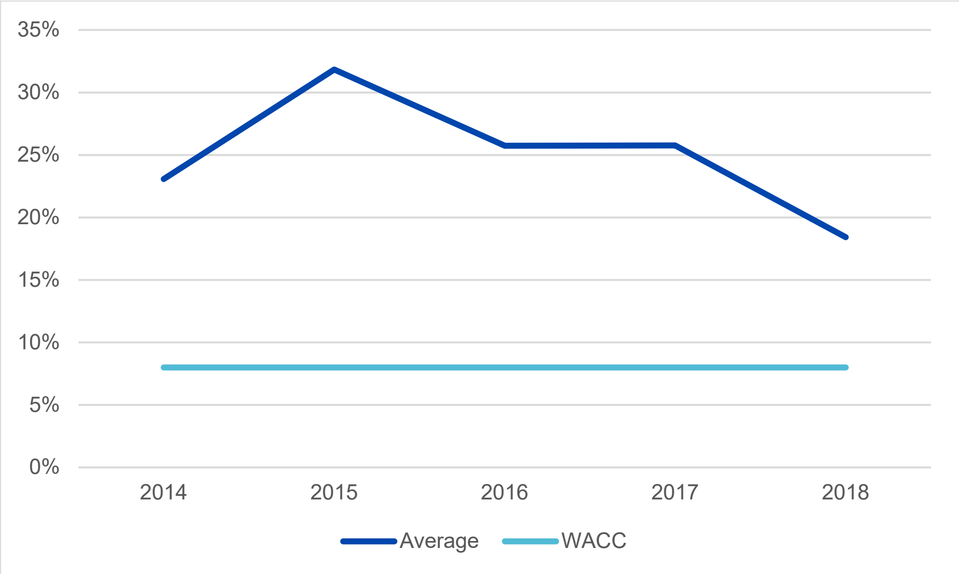
(c) Cost-plus.

Profitability

195. When analysing profitability of the firms we use ROCE where data permits, however we also consider it relevant to calculate economic profits and economic profits/cost-plus as alternative points of comparison across firms which may have different capital structures.

196. We have considered profitability on a firm-by-firm basis for the larger firms above. With consideration of the results of these 13 firms, it is evident that returns substantially in excess of the cost of capital have been made in the past five years.

Chart 1: Average ROCE of the larger funeral directors from 2014 to 2018, including WACC comparison (%)



Source: CMA analysis
Notes:
a) Chart 1 is a line chart with two lines, spanning from 2014 to 2018 inclusive. The darker coloured line represents the average ROCE of the larger funeral directors, and the lighter line demonstrates WACC.
b) The results of individual parties have been removed for confidentiality purposes. A consequence of this change is that text in paragraph 197 and related chart, were also excised.
c) The chart demonstrates that in all years the average ROCE is significantly higher than the WACC benchmark, which remains at 8% throughout the period.
d) The average line shows that ROCE starts at around 23% in 2014 before reaching its peak in 2015, at around 32%. Average ROCE drops in 2016, to just above 25% and remains consistent in 2017. There is a drop in ROCE in 2018, as it falls to around 18%.

197. [✂].

Chart 2: [✂]

198. [✂]. [The underlying data shows that] nine of the firms demonstrate ROCEs above WACC in all years from 2014 to 2018, and the average of the group sits between around 20% and 35%. Three of the thirteen firms display ROCE

results that are close to or lower than WACC in all years, with one firm demonstrating ROCE close to WACC in the most recent two years only.

199. The ROCE results across the group range from [0–5]% to [100–110]% across the firms over the five-year period. However, the main body of the group ranges between [10–20]% and [30–40]%.

200. Ten of the 13 firms have seen an overall decline in ROCE from 2014 to 2018, with three firms experiencing an increase in ROCE over the same period. While Firm A and Firm B see a drop in ROCE in 2017 and 2018, respectively, this is not evident across all the firms, with six firms showing steady ROCE and one seeing a marked increase.

201. In line with ROCE, there are similar patterns in terms of absolute economic profit per funeral figures, and economic profits as a percentage of cost plus.

202. The majority of firms earn economic profits in all years, with only three firms showing economic losses in all or some years from 2014 to 2018. Those firms making profits show an average of between £[250–300] and £[400–450] per funeral.

203. As with ROCE, Firm A and Firm B see a fall in their economic profit per funeral results in more recent years, however the results are still between £[100–150] and £[400–450] per funeral.

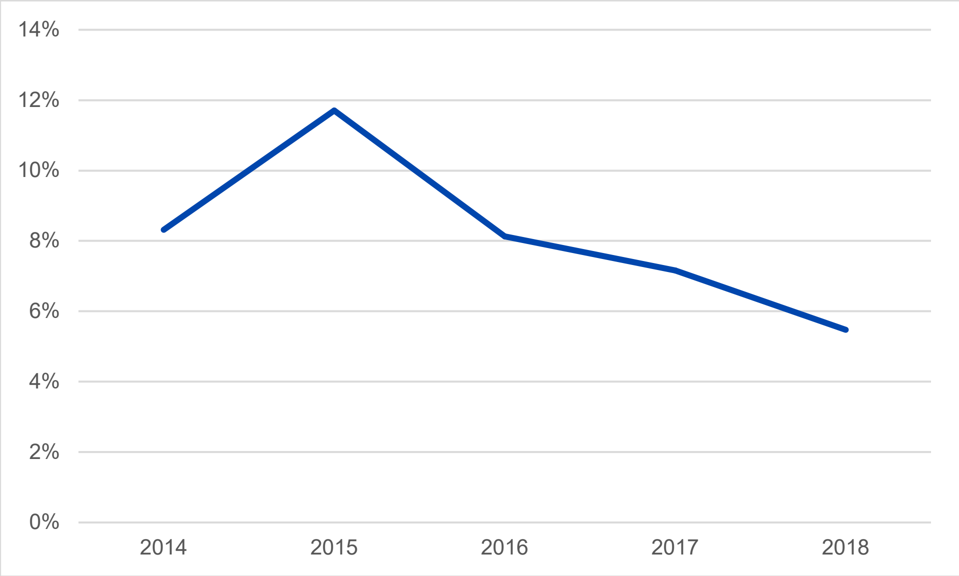
204. Economic profit (EP) as a percentage of cost-plus (CP) compares the economic profits of a business to its cost base (ie the costs through the profit and loss account plus the cost of capital). Thus, it shows us how much higher than cost prices have been.

205. This metric uses the cost-base of the company in question. Thus, using economic profits as a percentage of cost plus allows us to make a direct comparison of price versus cost for each party, and to compare the results across the group, regardless of the revenues charged or cost-base of each individual company.

206. There is a range of EP/CP percentages across the larger firms with an average result of 9%.

207. Looking at trends over time, the three largest firms generally achieved EP/CP percentages that were higher than the average across the group.

Chart 3: Average economic profits as a percentage of cost-plus from 2014 to 2018 for the larger firms (%)

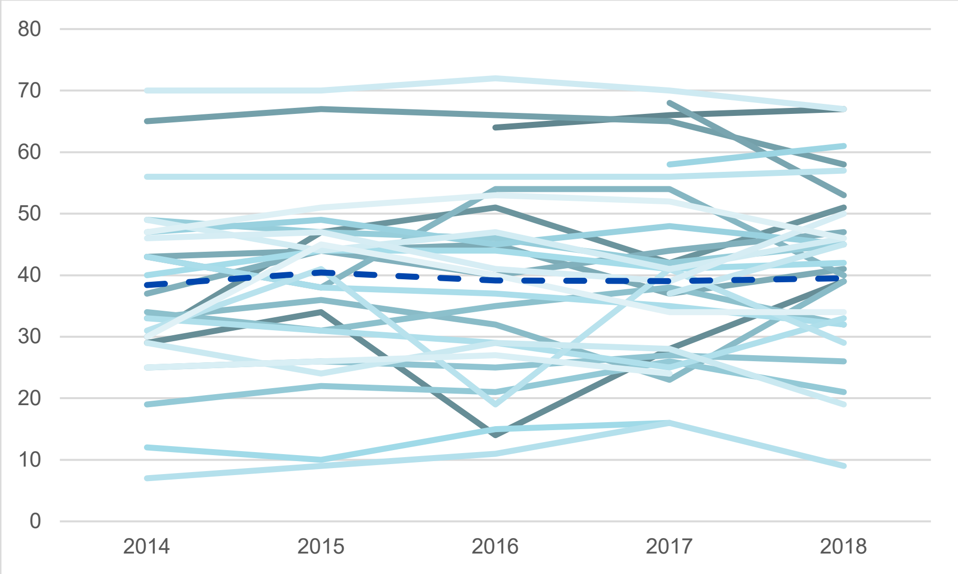


Source: CMA analysis
Notes:
a) The chart above is a line chart with one line demonstrating the average economic profits as a percentage of cost-plus of the larger firms from 2014 to 2018 inclusive.
b) The results of individual parties have been removed for confidentiality purposes.
c) The chart starts at just above 8% in 2014, increasing to just below 12% in 2015 before seeing a downwards trend to 2018 where it sits just below 6%.

208. [The underlying data shows that] only two of the firms have percentages that drop below zero, and one has results that consistently sit near to 0%. Otherwise, ten of the 13 firms earn EP/CP percentages that are consistently greater than 0%, demonstrating that they are generating economic profits over and above their cost-base, even with the inclusion of an allowance for cost of capital.

209. EBITDARS margin is the main metric of comparability across the smaller and larger firms.

Chart 4: EBITDARS margins of the smaller firms from 2014 to 2018 (%)[29]



Source: CMA analysis
Notes:

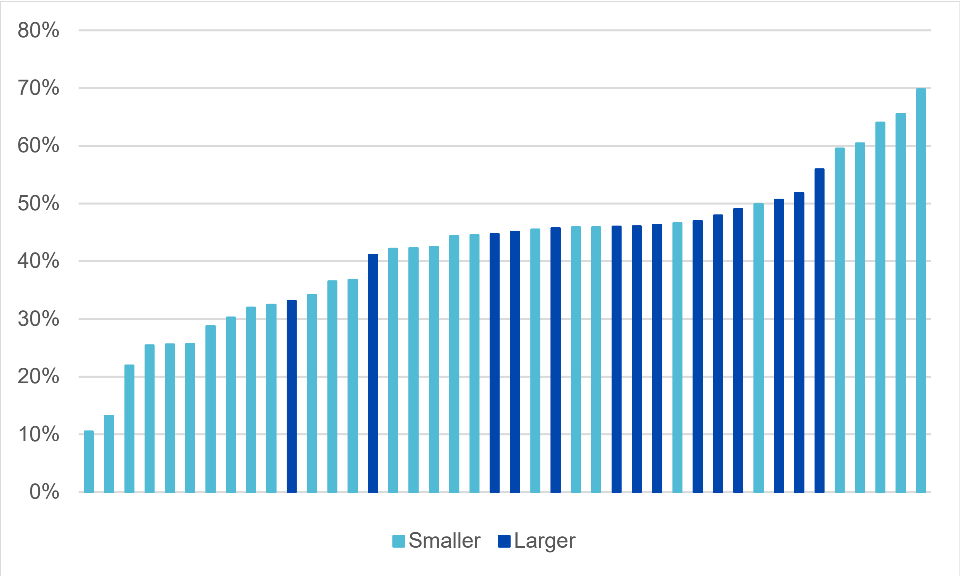
a) This line chart presents the EBITDARS margins of each of the 32 smaller firms analysed across the period from 2014 to 2018 inclusive, including an average benchmark.
b) The solid lines show individual party results, while the broken darker blue line demonstrates the group average.
c) Individual parties have not been identified for confidentiality reasons.
d) The chart demonstrates that EBITDARS margins of smaller firms vary widely both within each party across the time period and also across the parties.
e) The chart shows that the margins range from above 70% to less than 10%.
f) No apparent trend is discernible from the chart.

210. Chart 4 shows that there is no apparent trend in EBITDARS margins of the smaller firms but taking an average of the firms for whom we have obtained five years' worth of data, we note that margins have been maintained and have been slightly increasing.

211. Below, chart 5 demonstrates the range of EBITDARS margins across the board, including both the smaller and larger firms.

[29] The average line presented is calculated only from firms where data is available in all five years.

Chart 5: Average EBITDARS margins of smaller and larger firms (%)



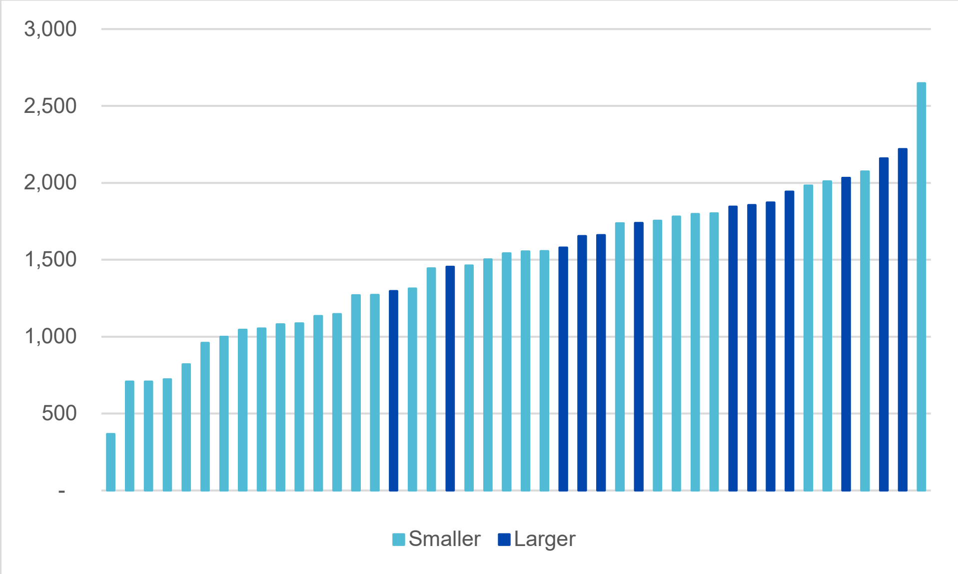
Source: CMA analysis
Notes:

a) Chart 5 is a bar chart. Some of the bars are lighter in colour, representing the smaller funeral director firms. The bars which are darker in colour represent the larger funeral director firms.
b) The firms can be identified only as 'smaller' or 'larger' and not by party name for confidentiality reasons.
c) The chart is structured with bars representing the lowest margins on the left, and the highest on the right.
d) The smaller firms (lighter in colour) dominate both the lower and higher ends of the charts but are otherwise largely mixed with the larger firms.
e) The lowest bar is around 10%, and the highest around 70%.

212. Per chart 5, smaller firms dominate both the lower and higher ends of the EBITDARS margins, however overall are mixed with the larger firms.

213. We also present a chart demonstrating average EBITDARS per funeral across the smaller and larger firms.

Chart 6: Average EBITDARS per funeral of smaller and larger firms (£)



Source: CMA analysis
Notes:

a) Chart 6 is a bar chart. Some of the bars are lighter in colour, representing the smaller funeral director firms. The bars which are darker in colour represent the larger funeral director firms.
b) The firms can be identified only as 'smaller' or 'larger' and not by party name for confidentiality reasons.
c) The chart is structured with bars representing the lowest average EBITDARS per funeral on the left, and the highest on the right.
d) The smaller firms (lighter in colour) dominate the lower end of the chart but are otherwise largely mixed with the larger firms.
e) The lowest bar is less than £500 per funeral, and the highest more than £2,500 per funeral.

214. Thus, the evidence suggests that smaller firms have the potential to earn returns equal to or greater than that of the larger firms, and some of them are doing so.

215. The generalised high level of profits appears to come from firms with very different average revenues and costs, and therefore we have examined these further to understand what may be driving this observation.

Average revenue per funeral (ARF)

216. Here we consider the range in average revenues as well as trends over time.

Range across average revenue

217. The results presented above show a significant range in ARF across the market, generally from £2,300 to £4,700.

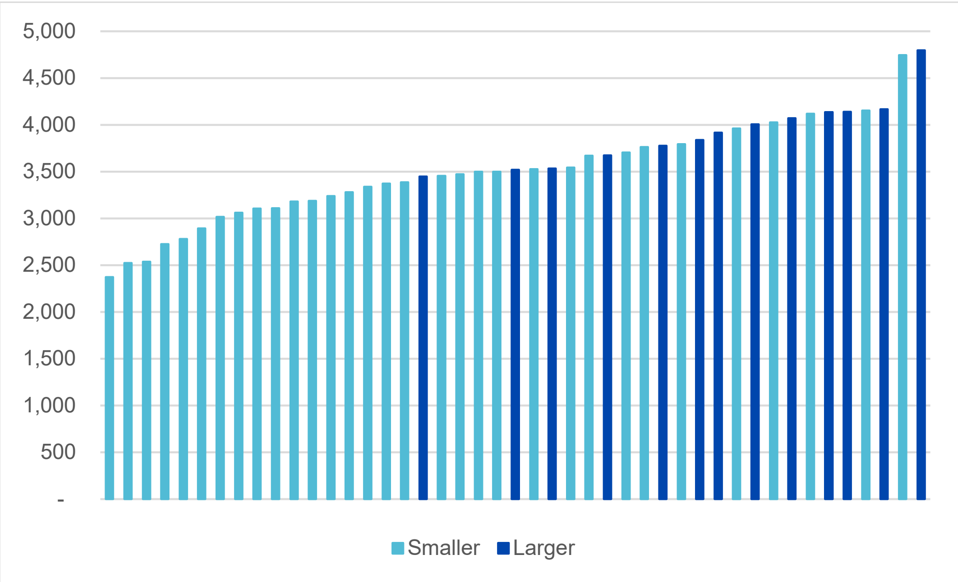
218. As detailed in Appendix A, we have noted that some of the lowest average revenue figures that we obtained in our investigation may be the result of figures being provided net of disbursements. However, during our investigation we have attended several site visits with smaller funeral directors

who have told us that they provide funeral packages including disbursements for around £2,500.

219. In analysing the results of the firms, we want to ensure that results are comparable and have therefore excluded results which we have reason to believe exclude disbursements and are therefore not comparable for the purposes of our current analysis.

220. Regardless, the results demonstrate that smaller funeral director firms are, on average, charging lower prices than larger funeral director firms. Of the 45 results presented, the lowest 50% of average revenues are largely made up of firms within the 'smaller' category.

Chart 7: Average ARF from 2014 to 2018 split between smaller and larger firms (£)



Source: CMA analysis
Notes:
a) Chart 7 is a bar chart. Some of the bars are lighter in colour, representing the smaller funeral director firms. The bars which are darker in colour represent the larger funeral director firms.
b) The firms can be identified only as 'smaller' or 'larger' and not by party name for confidentiality reasons.
c) The chart is structured with bars representing the lowest average ARF on the left, and the highest on the right.
d) The smaller firms (lighter in colour) dominate the lower end of the chart but are otherwise largely mixed with the larger firms.
e) The lowest bar represents ARF of just under £2,500, and the highest between £4,500 and £5,000 per funeral.

221. There is a greater mix of larger and smaller firms across the top 50% of average revenues. Larger firms are spread with smaller firms across the top 50% of average revenues. Firm A and Firm B both charge average prices at the higher end of the spectrum, with average revenues of £[✂] and £[✂] respectively.

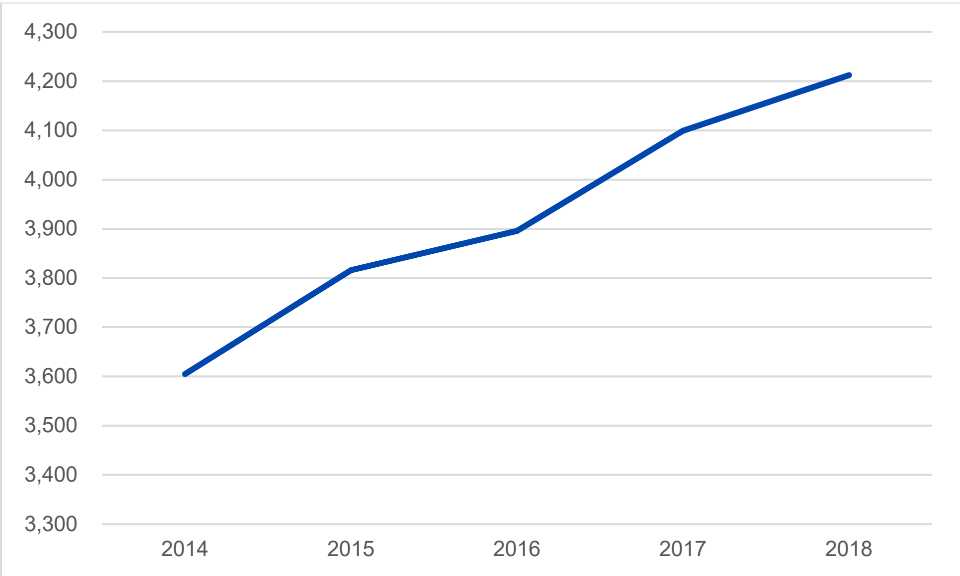
Trends in average revenue

222. Both Firm A and Firm B have told us that the market is changing. [✂] told us that 'changes are now taking place' and 'they are moving very quickly.' It said

that it is 'increasingly seeing customers shop around and consider price as well as quality and service.' [✂] told us that 'there is massive change coming through the funeral business' and that 'price competition is becoming more vigorous.'

223. As such, in considering average revenue results, it is relevant to consider trends across the five-year period in addition to evaluating averages. Chart 8 below shows the average revenue per funeral for each of the larger funeral directors over the relevant period.

Chart 8: Average ARF of the larger firms from 2014 to 2018 (£)



Source: CMA analysis
Notes:
a) The chart above is a line chart with one line demonstrating the average ARF of the larger firms from 2014 to 2018 inclusive.
b) The results of individual parties have been removed for confidentiality purposes.
c) The chart shows that ARF increases each year, beginning at around £3,600 in 2014 and increasing to more than £4,200 in 2018.

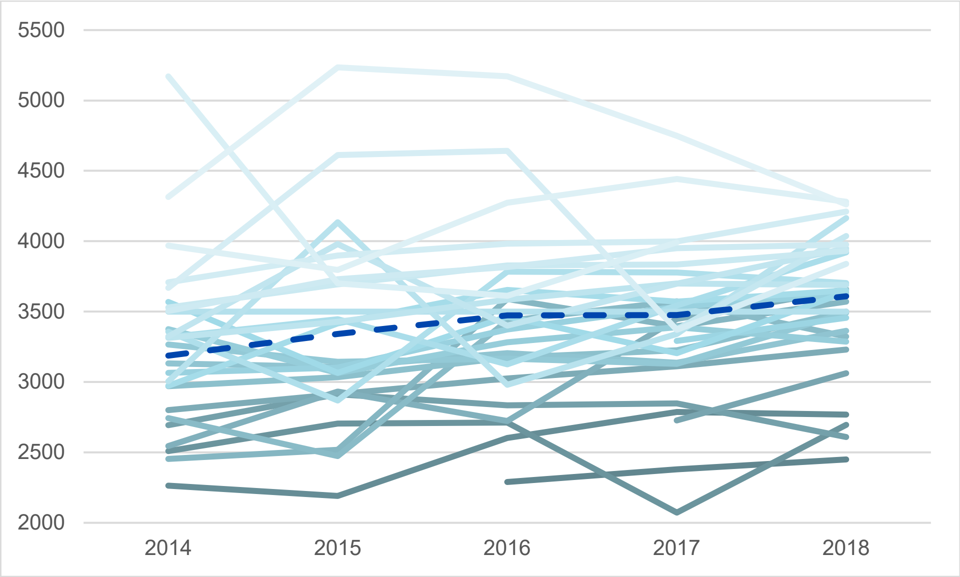
224. [The underlying data shows that] eleven of the 13 larger firms see a continued increase in ARF across the period. The increases in ARF have varied significantly across parties over the five-year period, with some of the biggest increases being observed among the regional larger players.

225. [The underlying data shows that] while Firm A and Firm B see a decline in ARF in the later period, this does not appear to be a generalised trend, with all of the other larger firms seeing year-on-year increases in ARF to a greater or lesser extent.

226. In terms of the smaller firms, the picture is more mixed. Of the 32 firms, 27 (84%) saw an overall increase in average revenues from 2014 to 2018. These increases were, on average, between £160 and £600 per funeral, which is equivalent to between 5% and 20% over the relevant period. Four

firms saw a reduction in average revenues across the period, and one firm's ARF stayed steady throughout.

Chart 9: Smaller firms' trends in average revenue per funeral from 2014 to 2018 including average benchmark (£)[30]



Source: CMA analysis
Notes:

a) This line chart presents the ARF of each of the 32 smaller firms analysed from 2014 to 2018 inclusive including an average benchmark. The solid lines show individual party results, while the broken darker blue line demonstrates the group average.
b) Individual parties have not been identified for confidentiality reasons.
c) The chart demonstrates that ARFs of smaller firms vary widely both within each party across the time period and across the parties.
d) The chart shows that one party has an ARF as low as just over £2,000 in one year, and another with ARF as high as around £5,200 in another year.
e) No apparent trend is discernible from the chart.

227. The results per chart 9 above demonstrate significant 'noise' across the smaller funeral director firms' ARF. There is no evidence of a downward trend at the end of the five-year period, rather a continuation of the year-on-year volatility in average revenue per funeral that is likely to be the result of small volumes and composition effects.

228. Taking an average across this group of smaller firms demonstrates an overall increase in ARF of the smaller firms from 2014 to 2018 inclusive. ARF increases from 2014 to 2016 before remaining steady from 2016 to 2017, after which it increases again in 2018.

229. The decline in average revenue per funeral is only observed for Firm A and Firm B among the larger firms and there is no discernible trend among the smaller firms, in part because they exhibit year-on-year volatility. In practice, this means that we are not seeing a market-wide change in ARF.

[30] The average line presented is calculated only from firms where data is available in all five years.

230. Therefore, our preliminary view is that the evidence does not support the contention that changing market dynamics are exerting downward pressure on profits (via downward pressure on prices) in the last couple of years. When we gather information from 2019, we will gain insight into whether a downward trend is becoming more apparent.

Cost-plus per funeral

231. Cost-plus is calculated as all costs relevant to funeral director services through the P&L plus the cost of capital. Due to the nature of the information obtained from the smaller firms (as detailed in Appendix A) we have not been able to calculate cost-plus per funeral for these firms. Thus, the discussion presented in this section relates to the larger funeral directors only.

Range across cost-plus

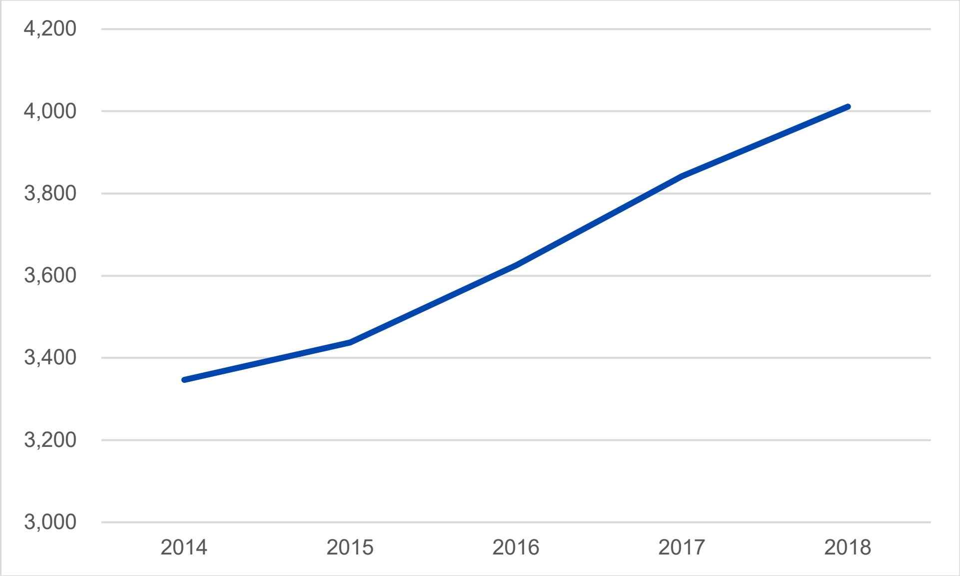
232. There is a significant range in average cost-plus incurred by the larger funeral directors, from just over £3,000 to almost £5,000. Most funeral directors incur average cost-plus of between £3,200 and £3,700, although some firms have average cost-plus figures in the £4000s, at around £4,100 and £4,800, while another firm has cost-plus of just over £3,000, on average.

233. Funeral directors demonstrating high ARF results typically also incur higher cost-plus. While the three largest funeral directors sat at the top of the range for revenues, and they continue to do so for cost-plus, they do (on average) move slightly further down the list.

Trends in cost-plus

234. Chart 10 below demonstrates trends in cost-plus for the larger firms from 2014 to 2018.

Chart 10: Average cost-plus of the larger firms from 2014 to 2018 (£)



Source: CMA analysis
Notes:

a) The chart above is a line chart with one blue line which represents the average cost-plus of the larger firms from 2014 to 2018 (inclusive) in pounds.
b) For confidentiality purposes, this chart presents the average of all parties only, and not individual party results.
c) The chart starts in 2014 at just below £3,400 and increases to around £4,000 by 2018.

235. [The underlying data shows that] the three largest firms have kept cost increases to around £500 per funeral over the period, whereas the other larger firms present a much more mixed picture.

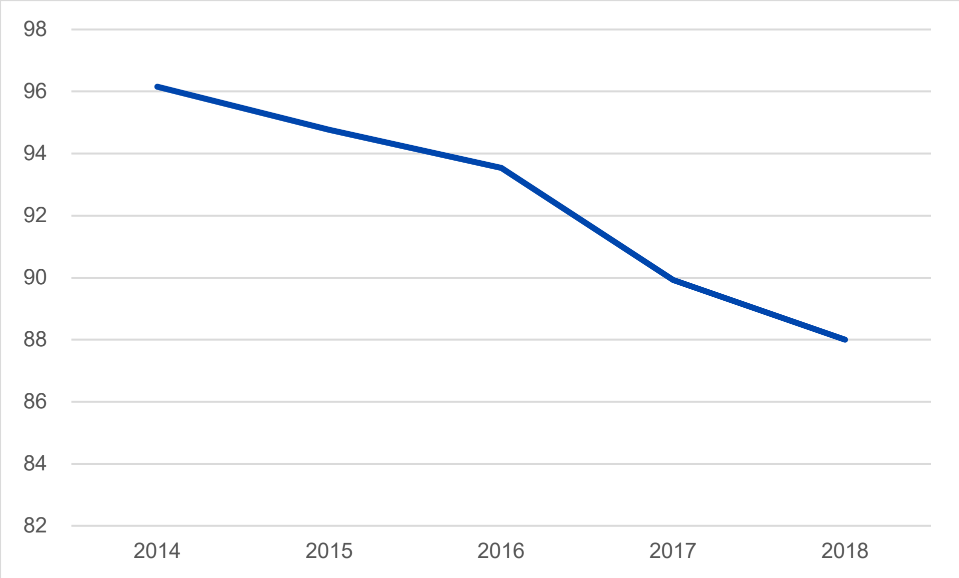
236. Some funeral directors have seen small increases in costs. For example, Firm D has seen an increase in cost-plus per funeral of approximately £[300–350], significantly lower than the approximately £600–£700 increase of many of the funeral directors, and four times lower than the increase of £[1,200–1,300] we calculated for Firm J.

237. As a result, in 2018 the three largest firms have cost-plus relatively lower in comparison to the other larger firms than in 2014, and the gap with the lowest cost firms has narrowed somewhat. However, some of the firms have sustained lower costs throughout and continue to undertake funerals with a relatively low cost-plus per funeral.

238. One might expect a reduction in funerals per branch to contribute to the increase in cost-plus. We note that all of the firms who have seen a fall in the number of funerals per home have also seen large increases in cost-plus of between £600 to £1,200. This could be a result of reduced efficiencies with the decrease in number of funerals per home, although also could be down to many other factors such as an increase in capital employed (and thus cost of capital) or increases in the cost-base more broadly. In the next section we

consider what may be driving trends and differences in cost-plus across the group.

Chart 11: Average funerals per branch of the larger firms from 2014 to 2018



Source: CMA analysis
Notes:
a) The chart above is a line chart with one blue line which represents the average funerals per branch of the larger firms from 2014 to 2018 inclusive.
b) For confidentiality purposes, this chart presents the average of all parties only, and not individual party results.
c) The chart starts in 2014 just above 96 funerals per branch, and decreases year-on-year, falling to around 88 funerals per branch in 2018.

Drivers of ARF and Cost-plus

239. A number of factors may contribute to the very different levels of ARF and cost-plus observed across the various funeral directors that we have analysed. These include:

(a) Disbursements: we have included disbursement revenues and costs in our analysis above. As such, choices made by the customer around disbursements, such as burial or cremation will have an impact on both revenues and costs.

(b) Product mix: funeral directors providing more simple funerals than standard funerals will earn lower ARF yet would also be expected to incur lower costs.

(c) Region: location is likely to have an impact on the costs incurred by funeral directors. For example, more affluent areas are likely to see funeral directors paying higher property and/or staff costs, both of which contribute to cost-plus and may be expected to have an impact on average revenues.

(d) Quality: true quality differentials could have an impact on the costs incurred by funeral directors to provide a high-quality service, which would be expected to be reflected in higher ARF.

(e) (In)efficiency: some firms may be able to charge lower prices as they are more efficient and thus have lower costs. Conversely, other firms may be inefficient, resulting in higher costs to undertake the same work, and consequential higher prices. We note that differences in volume of funerals per branch may contribute to efficiency.

240. In the context of our profitability analysis, we note that the first four of these factors may give rise to 'justifiable' differences in cost-plus and average revenues per funeral. However, to the extent that some of the differences in cost-plus across the firms are the result of inefficiency rather than the other reasons set out above, our analysis will understate the (pricing) detriment to consumers.

241. Based on the analysis that we have carried out to date, which does not seek to adjust for (in)efficiency in firms' costs bases, taking a view across the results of all the companies we have analysed, it appears to us that:

(a) Looking at the 13 largest firms, accounting for 42% of funeral director branches in the UK, returns substantially in excess of the cost of capital have been made in the past five years.

(b) Looking at the industry overall, the data we have collected from a variety of firms indicates that, regardless of size (larger or smaller firms), firms are capable of making large returns and some do so.

(c) High margins are being made both by firms that achieve a high level of revenue per funeral and firms that appear to be charging their customers significantly lower prices.

242. Based on our analysis of trends in average revenue per funeral, our preliminary view is that the evidence does not support the contention that changing market dynamics are exerting downward pressure on profits (via downward pressure on prices) in the last couple of years. Looking at average ROCE figures across the 13 largest firms, although there has been a decline in the profitability of Firm A and Firm B in very recent years, no such trend is apparent among other large firms overall.

Appendix A: Obtaining information from funeral director firms

1. We faced challenges in obtaining information from some funeral director firms. In this appendix, we cover the issues faced and methods taken to obtain data from these funeral director firms.

2. First, we focus on the limited issues faced in obtaining data from some of the larger firms, and secondly (and more substantially) the challenges faced in obtaining data from the smaller firms.

Challenges in obtaining data from larger firms

3. Two of the larger firms were not able to provide balance sheet information relating to the provision of funeral director services for the full Historic Period. One firm could not provide any balance sheet information, while the other could provide information for 2014 and 2015 only.

4. [✂].

5. Firm K could provide comprehensive balance sheet information from 2016 onwards but not prior. In order to obtain capital employed figures for 2014 and 2015, we: (i) used the information provided on owned properties and calculated NBV based on a 50 year useful economic life; (ii) used an average of 2016, 2017 and 2018 figures for vehicles and 'other' fixed assets based on the asset registers provided, and (iii) calculated average debtor and creditor days based on the information provided by the rest of the mid-tier firms alongside available revenue and cost of sales information to create an estimate of working capital for 2014 and 2015.

6. For Firm I, balance sheet information was not available for any year, however asset registers were provided detailing relevant fixed asset information. As with Firm K, we used average debtor and creditor days to calculate working capital. Information per the asset registers combined with calculated working capital formed capital employed in the analysis of this mid-tier firm.

Challenges in obtaining data from smaller firms

7. Throughout this investigation we have come across many challenges in obtaining information from smaller funeral directors. Parties have raised questions as to how we plan to obtain information from these smaller firms, and how we propose to compare their results to the larger players in the market.

8. This appendix details our approach to evidence gathering and analysis particularly related to these smaller funeral director firms. We focus on:

(a) Obtaining information, including:

(i) our initial approach to obtaining information;

(ii) comments made by parties on our information gathering approach; and

(iii) our revised approach to obtaining information.

(b) Analysis of information, including:

(i) party views;

(ii) our interpretation of the information received; and

(iii) comparability metrics used in our analysis.

Obtaining information

Our initial approach to obtaining information

9. Firstly, we collated a representative sample of 100 funeral director branches, to whom we sent reasonably detailed questionnaire. These questionnaires requested financial information on a branch-level basis comprising:

(a) Profit and loss, covering information such as:

(i) revenue split between (a) revenue comprised from funeral director services and (b) disbursement revenue; and

(ii) costs broken down into key categories: cost of goods; overheads (rent, staff costs, vehicles, business rates, other); amortisation; and, depreciation.

(b) Balance sheet, as per our financial template, to allow for comparison across the parties. Key balances requested were: intangible assets; tangible assets; inventories; debtors; cash; other current assets; creditors due within one year; other current liabilities; long-term liabilities; capital and reserves.

(c) Asset registers categorising assets as (i) properties, (ii) vehicles, (iii) other, split between:

(i) owned;

(ii) finance leased; and

(iii) operating leased.

10. Despite attempts to assist companies in interpreting how to respond given their specific circumstances (including telephone conversations and additional written guidance), we received relatively few responses, often of poor quality.

11. We found that parties struggled to identify meaningful balance sheet data. Some of the key issues they faced included the following:

(a) Parties were unable to split assets by branch due to holding records at a total level, where the firm operated more than one branch;

(b) Parties could not provide information on key assets, such as properties, because these were owned by an individual (ie the funeral director themselves) and 'leased' to the company free of charge;

(c) Many firms did not maintain detailed asset register information and therefore could not provide the information at the level of the detail requested;

(d) Limited asset information was available from sole traders due to more limited record-keeping requirements.

12. Where we did receive balance sheet information from funeral directors, the cross-checks we carried out indicated that in some cases there were inaccuracies in the way the information had been recorded and there was no way to address such inaccuracies.

13. We found one key issue with regards to profit and loss information, being that funeral directors were often not able to provide revenue figures that split out funeral director services from disbursements. Any estimates of percentage splits based on total revenue figures were their best guess.

Comments made by parties on our information gathering approach

14. Some of the comments raised by parties on our information gathering approach are detailed in the 'Market Coverage' section of the main body of text, at paragraph 12.

15. Through discussions with funeral directors throughout our information gathering process, we noted that several of them were struggling to complete our information request. Further, we spoke with SAIF who highlighted a number of difficulties that their members were having with the questionnaire.

Our revised approach to obtaining information

16. In response to concerns raised and limited responses obtained in the first instance, we opted to revise our approach to obtaining information from the smaller parties.

17. We spoke to SAIF to understand what difficulties companies were having with our information request and received other feedback from conversations with independent funeral directors who had responded to our questionnaire or who had attempted to respond. We then revised the questionnaires in the light of what these various parties told us. Key changes included:

    (a) requesting information at a company-level, rather than a branch-level;

    (b) removing the requirement to split out disbursement revenue from revenue earned from funeral director services;[31]

    (c) removing the need to provide asset registers and allowing balance sheets as submitted to Companies House to be provided, rather than requiring a specific template to be completed.

18. We issued the revised questionnaires using our powers under s174 of the Enterprise Act 2002.

19. As a result, we have achieved an increased response rate.

20. We still have some concerns around data quality, as set out below. We consider, however, that this is unavoidable given the nature of some of these businesses. It is clear from the answers we received that, some of the smaller funeral directors were unable to provide meaningful financial information, despite the relatively simple nature of the updated request we sent to them.

21. We believe that the information obtained is the best available bearing in mind their financial capabilities and constraints on their time. Our approach was developed following discussions with a number of smaller funeral directors as well as SAIF.

22. While our request was initially sent to a representative sample, the limited number of responses received means that the sample is no longer considered representative, but we believe the information obtained remains informative.

[31] All average revenue figures presented in this paper therefore include disbursements.

Analysis of information

23. In analysing the information that we obtained from the parties, we considered points raised by parties with regards to how information may be interpreted, as well as the quality and detail of the information itself. In this section we discuss: (a) points raised by parties with regards to how we may interpret the information; (b) how we interpreted the information received and any issues that we faced in terms of the detail and the reliability of information obtained; and, (c) the comparability metrics that we believe to be most appropriate in comparing the results of the smaller funeral directors to those of the larger firms.

Party views

24. Below, we detail points raised by parties with regards to our analysis of smaller funeral director firms followed by our consideration of the points they raised.

- *Points raised by parties*

25. Funeral Partners said that 'very local level criteria will play into any findings' for the independents as 'the CMA's profitability analysis will take place at the branch level (rather than at a provider level).' They said that 'the approach would be likely to miss elements of 'back office' costs for the businesses and thus distort profitability comparisons.'

26. In relation to a large amount of the market being made up of smaller providers, Co-op told us that 'the robustness of the conclusions regarding any AEC will be dependent on the quality of evidence that is available on the profitability and the cost of capital of the independent providers.'

27. Co-op highlighted concerns around the stratification of our sample, noting that a range of dimensions will contribute to differences across the independent market, including points such as whether the funeral director is a new entrant or an established owner. It also referenced medium sized independent operators and noted that the representativeness of our sampling will be dependent 'on whether these regional scale players are adequately considered.'

28. Lastly, Co-op noted that 'local competitive conditions at the point in time the profitability is measured will also be an important driver of profitability.'

29. In response to our profitability approach paper, Dignity noted that 'many of the independent providers are owner-operated.' As such, Dignity said that we

should 'consider relevant information on the owner's personal earnings/dividends/assets used in the business if these are to be incorporated fully in the analysis, and on a comparable basis to the three larger corporate groups.'

30. Similarly, Funeral Partners said that 'within the independently owned part of the market, the full cost of owners' inputs into businesses is typically not reflected in their financial performance and published results.' It said that 'owner managers of independently owned businesses tend to work extensively within their businesses without fully charging the costs of such input into the business, this resulting in a higher level of profitability being presented.'

31. NAFD noted that 'there may be a 'survivorship bias' such that the firms currently in the market, particularly the largest, are particularly profitable and efficient, and that other firms went bankrupt in the past.'

- *Our consideration of the points raised*

32. In terms of Funeral Partners' point on the locality of the branch-level analysis and potential for 'missed costs' due to the apportioning of information for the purpose of providing branch rather than company-level data, we note that we revised our information requests to obtain company-level results from smaller funeral director firms, while also extending our analysis to obtain company-level information from more 'larger' firms.

33. Similarly, in terms of Co-op's point on the inclusion of 'regional scale players', we have extended our analysis to cover this point by including the next ten largest firms by branch following the three largest firms, which means we now include results from a number of regional family-firms and regional co-operatives.

34. We recognise that many factors will contribute to differences across the sector such as being a new entrant or an established owner. The metrics used in our analysis (detailed further at paragraph 50 below) look to minimise these fluctuations as much as possible. However as outlined in the main text, we acknowledge that a number of factors related to revenues and costs will impact the results of all players in the market regardless of size, structure or location. Nevertheless, we observe that smaller firms have the capacity to earn EBITDARS margins in the range of that of the larger firms.

35. There is inevitable variation in the quality of the evidence obtained, which reflects the differences in the size and structure of the range of funeral directors who are active across the sector. We have, however, worked to

obtain high-quality data and, based on the differing levels of detail we have been able to obtain, we have adjusted our metrics accordingly. We have excluded from our analysis any data which we consider to be entirely unreliable. However, we believe that we have been able to obtain sufficient data of appropriate quality to enable us to carry out profitability analysis which gives insight across the market.

36. The staff-cost issues raised with regards to owner-operated businesses have been a key consideration in our analysis of smaller funeral director firms. We note our approach to this in more detail at paragraph 40 below.

37. In terms of survivorship bias, we have not seen evidence of firms exiting due to financial pressures. While Dignity's evidence in its response to the profitability approach paper showed churn, this can be expected in an industry with a large number of family firms as the result of various factors such as retirement etc. Thus, we are not convinced of the relevance of any survivorship bias.

Our interpretation of the information received

38. In reviewing the information obtained from these smaller funeral director firms, we noted some points of consideration with regards to our analysis and comparisons across the wider group of companies which we analysed. The two key points considered were (a) any limitations to the balance sheet information obtained, and (b) the reliability of salary cost information provided with regards to actual costs to organise a funeral.

39. Each of these two points is considered in turn below, followed by other more general data reliability issues we came across.

Comprehensive nature of balance sheet information

40. While the balance sheets provided were useful in providing insight into the smaller providers in the funeral director market, the balance sheets were not detailed enough to calculate meaningful capital employed figures to allow for comprehensive ROCE analysis to be performed.

Salary costs

41. As raised by parties and outlined the narrative above, we recognise that smaller funeral director firms may not incur salary costs reflective of the work being undertaken by staff, or owner-operators. There are two key elements to this:

(a) remuneration being taken in the form of a dividend rather than as a salary; and

(b) the full 'cost' to the business of the owner-operators' contribution is not reflected in the amount of remuneration taken.

42. Firstly, we consider the form in which remuneration is paid. Owner-operators are likely to take the majority of their remuneration as a dividend as opposed to as a salary. By doing so, the cost to the business of the person's contribution is not reflected in the profit and loss. Thus, profitability will appear higher where remuneration is taken as dividends rather than expensed through the profit and loss as a salary expense.

43. This is standard practice for owner-operated firms. However, it means that we must think about the profit and loss results differently for our analysis as they may not be fully reflective of staff costs.

44. Secondly, we consider whether the full 'cost' to the business is being charged. Regardless of the means by which the owner-operator receives their pay (ie as a salary or dividend).

45. We understand that an owner-operator may work more hours than would be expected of a standard full-time employee, without the corresponding remuneration.

46. As raised by Funeral Partners at paragraph 29 above, profitability will thus appear higher as the full costs have not been charged to the business.

47. We reviewed evidence from Dignity which demonstrated that when Dignity acquired an independent business, staff costs increased significantly. We consider that at least part of this difference is likely to be the result of recording the salaries of all employees in P&L expenses (whereas independents may reflect such 'costs' in their profits).

48. Taking the above factors into consideration, in performing our analysis we have therefore used earnings before interest, tax, depreciation, amortisation, rent and staff costs (EBITDARS) in comparing the results of smaller and larger firms.

Other data reliability issues

49. When reviewing the results of our analysis, we noted various instances where the data appeared unreliable. These included:

(a) Average revenue per funeral in the region of £500; we consider this to be vastly below what could realistically be any funeral director's average revenue per funeral and therefore appears to be incorrect.

(b) Very low cost of sales figures, giving a gross margin of approximately 99% to 100%. We would expect cost of sales to make up a reasonable percentage of revenue and therefore do not consider the information provided in these instances to be accurate.

50. As such, in reviewing our results, we split out the results which seemed to be accurate from those which did not appear to be meaningful.

Comparability metrics used in our analysis

51. With consideration of the difficulties of obtaining meaningful data from smaller funeral directors, when analysing the financial results, we have focused on the following key metrics:

(a) average revenue per funeral; and

(b) EBITDARS margin

52. These metrics focus on profit and loss results only.

Average revenue per funeral

53. Average revenue per funeral is inclusive of disbursements and is a comparable metric across all parties. This takes the total revenue generated by the funeral director firm for the provision of funeral director services and divides it by the number of funerals performed in the same financial year.

EBITDARS margin

54. We consider the EBITDARS margin to be most appropriate in making comparisons across the firms. This margin presents the operating performance of the companies regardless of capital and financial structure.

55. This allows for comparison of the parties regardless of whether they own or rent their properties, and other non-operational factors such as rent and interest on lending. Further, the margin excludes amortisation and depreciation therefore the age of a firm's assets will be excluded from the comparison.

56. Perhaps most significantly, with regards to the nature of the smaller funeral director firms, this metric allows comparison of the returns being made

through funeral operations regardless of the means or amount of remuneration paid to staff.