CARRIAGE SERVICES, INC.

Moderator: (Chris Jones)
October 30, 2014
10:30 a.m. ET

Operator: Good day, ladies and gentlemen, and welcome to the Carriage Services Third Quarter 2014 earnings conference call.

At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will follow at that time. If anyone should require assistance during the conference, please press star then zero on your touchtone telephone. As a reminder, this conference call is being recorded.

I would now like to turn the call over to your host, Mr. (Chris Jones) representing Carriage Services. (Mr. Jones), you may begin.

(Chris Jones): Thank you and good morning, everyone. We're glad you can join us. I'd like to welcome you to the Carriage Services conference call.

Today, we will be discussing the company's 2014 third quarter results, which were released yesterday after the market closed. Carriage Services has posted a press release including supplemental financial tables and information on its website at carriageservices.com. This audio conference is being recorded and an archive will be made available on Carriage's website.

Additionally, later today a telephone replay of this call will be made available and active through November 3rd. Replay information for the call can be found in the press release, which was distributed yesterday.

Speaking on the call today for management are Mel Payne, chairman and chief executive officer; and Bill Heiligbrodt, executive vice president.

Today's call will begin with formal remarks from management followed by a question-and-answer period. Please note that during the call management will make forward-looking statements in accordance with the Safe Harbor provision of the Private Securities Litigation Reform Act of 1995.

I'd like to call your attention to the risks associated with the statements, which are more fully described in the company's report filed on Form 10-Q and other filings with the Securities and Exchange Commission.

Forward-looking statements, assumptions or factors stated or referred to on this conference call are based on information available to Carriage Services as of today. Carriage Services expressly disclaims any duty to provide updates to these forward-looking statements, assumptions or other factors after the date of this call to reflect the occurrence of events, circumstances or changes in expectations.

In addition, during the course of this morning's call, management will reference certain non-GAAP financial performance measures. Management's opinion regarding the usefulness of such measures, together with the reconciliation of such measures to the most directly comparable GAAP measures, or historical periods, are included in the press release and the company's filings with the Securities and Exchange Commission.

Now I'd like to turn the call over to Mel Payne, chairman and chief executive officer.

Mel Payne: Thank you, (Chris). Welcome to our third quarter call. I'm going to turn the call over to Bill Heiligbrodt to go over the details of our performance.

L. William Heiligbrodt: Thank you, Mel, and good morning everyone. As always there's a great deal of information in our third quarter press release. To the extent that anyone has questions on this release we can address them after our comments today or, for that matter, personally after the call. We welcome that opportunity.

Now let's go to some of the important details of this record third quarter. First, I have to mention adjusted diluted earnings per share. This record adjusted diluted earnings per share were 31 cents for the third quarter of 2014, an increase of just under 100 percent. Year-to-date adjusted diluted earnings per share for September 30, 2014 are 94 cents and the increase of a little less of 30 percent. Let me remind you adjusted diluted earnings per share for the full-year 2013 were 98 cents.

Next I would like to address adjusted free cash flow for Carriage Services.

For the first six months of 2014, adjusted free cash flow was down 26 percent, fueled by 70 percent growth in adjusted free cash flow in the third quarter 2014, we finished the quarter up 2 percent so we move from the second quarter being down 26 percent to the third quarter being up 22 – being up 2 percent and ended the quarter with $27 million in adjusted free cash flow. Therefore, there is a good chance that we could end the year 2014 with a record adjusted free cash flow in excess of $40 million.

Finally, I would like to look to the future again including the remainder of 2014 using and evaluating the eight key factors I discussed with you on this conference call at the conclusion of the second quarter.

First point, we should see better comparisons in same-store volume in the third and fourth quarters of 2014. For the third quarter of 2014, same-store funeral revenue was up 2.6 percent, while year-to-date same-store funeral revenue was down 2.1 percent.

Remember, we began this year in the first quarter 2014 with same-store funeral revenues down 6.5 percent. Since then we have seen steady improvements in same-store funeral comparisons, which we think will continue into the fourth quarter. This is exactly opposite of 2013 where we began the year up 5 percent in same-store funeral revenue and saw declines for the remainder of the year ending up 7/10 of 1 percent for the full-year.

This is truly reflective of funeral trends, which have been exactly opposite for 2013 compared to 2014 and again emphasizes that funeral cycle tend to run randomly and in periods longer than one quarter. Again, we believe same-store funeral revenue will improve in the fourth quarter allowing us to possibly grow for same-store funeral revenue for the whole of 2014.

Second point, during the second quarter of 2014 we replaced $90 million of junior subordinated convertible securities compared to 7 percent interest rate with a new seven-year convertible note of $143.8 million at 2.75 percent.

The annual cash interest savings on this refinancing is $2.35 million. It is reflective in reduced interest expense in our third quarter 2014 statement and will carry-forward into the fourth quarter 2014 and into 2015 on a comparable basis.

Third point, we have a new $325 million credit facility completed in the second quarter of 2014 comprised of $125 million term loan and a $200 million revolving credit. Currently, we have almost $160 million available under this revolving credit plus our free cash flow of possibly $40 million or more per year to finance Carriage's growth program. Floating interest rates on this revolving credit are currently under 3 percent.

Fourth point, in May of the second quarter we completed the purchase of six businesses with Service Corporation International for approximately $54 million. After reviewing our third quarter financials, those acquisitions are doing slightly better than reported in the second quarter and should now add 23 cents on an annual basis. This can be seen in the rising performance numbers for funeral acquisitions both in terms of revenue and field EBITDA.

For the third quarter of 2014, funeral acquisition revenue was up 50 percent and field EBITDA was up 72 percent. These numbers exceeds comparable growth numbers shown in the second quarter of 2014.

Fifth point, the third quarter now reflects both the full benefit of the new financing and the new acquisition. That will be the case in the fourth quarter and end of 2015.

Sixth point, responsible Carriage management has been reviewing all overhead expense numbers to be certain there is added value in all these expenses. Total regional and corporate fixed overhead expenses are down over $900,000 for the third quarter 2014. Some future reduction in expenses should occur in the fourth quarter of 2014.

Seventh point, comparisons of adjusted diluted earnings per share continue to be easier as we move through the fourth quarter and the first half of 2015.

Eighth point, in the second quarter earnings call we reported our new calculation of our cost of capital as being slightly under 8.5 percent. That number has been recalculated at the end of the third quarter with nominal improvement and remain slightly under 8.5 percent, which continues to put Carriage in a very competitive position for company our size to deliver real value for our shareholders.

In summary, the combination of these eight points allows us to increase our rolling fourth quarter outlook from a range of $1.42 to $1.48 from June 2015 to $1.49 to $1.54 range for the period ended 9/30/2015.

This concludes my remarks and we look forward to reporting our results as we move forward the remainder of 2014.

I'll turn it back over to you, Mel.

Mel Payne: Thank you, Bill.

As I stated in our press release, Carriage, as a funeral and cemetery business, consolidation and operating platform has never had such a high-quality of operating and corporate leadership broadly at all levels who are more aligned with our guiding principles and the high performance operating and financial standards, nor have we ever had an industry landscape of high-quality industry acquisition candidates more favorable towards Carriage as the preferred choice as a family succession solution.

And on that point, I'd like to make a few more comments.

Since Dave DeCarlo joined the company in March, he and I – because we had time and the company was doing well in most other areas – spend a considerable amount of time relooking at our 10-year vision, our strategic focus on what was a strategic market – large, medium, small – how we would allocate our free cash flow and capital over the next five or 10 years, and then we've rewrote and refocused the Acquisition and Corporate Development Group and rebuilt that group over the last three months in particular.

We have made enormous progress in identifying where do we want to spend our time to build a portfolio of businesses that are really perfect fits for our standards operating model and will be higher growth, revenue, cost, and profit businesses compared to our existing portfolio as we execute the strategic acquisition model.

Dave and I, in particular, spend a lot of time in various markets. And so now we have come up with a plan. It's highly focused. The pipeline of quality acquisitions within this framework and within these markets is growing. We will make acquisitions of high-quality businesses in the next six months. And I expect that to continue well into the future. So this will be a real focus over the next two years, and it should have a lot of earning power to the company as we do it, as Bill mentioned, finance with a low cost of capital and a lot of free cash flow.

Therefore, we are confident that effective execution of our three models will produce high and sustainable operating and financial performance through the 2.25 quarter remaining on our defined five-year Good to Great Journey so that by the end of 2016 we will have annualized earning power roughly equal to approximately $2 per share of adjusted diluted earnings per share.

This is not a forecast. This is a goal, but we take our goal seriously. And if we achieve that goal – when we achieve that goal, by then we will have developed new goals for another five-year timeframe to continue the never-ending Carriage, what we call Good to Great Journey.

Finally, after a quadrupling of our stock price from about $5 per share at the end of '11 to briefly over $20 per share in April 2013, short amount of time, our stock price has been consolidating. I call it the pause that refreshes, mostly in the $16 to $20 per share range for the last 18 months.

However, as the largest single individual shareholder with about 8 percent of fully diluted shares I long ago learned that the stock price is not the company. And while the stock price paused in the $16 to $20 per share range, the company itself has continued to rapidly improve its sustainable earning power and prospects for the future.

In other words, it is a good period to be an owner of Carriage, which includes all of our senior leaders and many of our employees who take great pride in contributing toward our success individually and in teams who make a measurable difference. We are extraordinarily well-positioned, therefore, to create substantial shareholder value in the future for those who take the Good to Great Journey with us.

I'd like to end this call by customarily calling out our third quarter high performance heroes because these are the people who produced the performance that we all own.

In the eastern region and a repeat performer from the second quarter, John Fitzpatrick, Donahue-Cecere Funeral Home, Westbury, New York; Jason Higginbotham, Lakeland Funeral Home, Lakeland, Florida; Scoitt Griffith, Woodtick Frigon Funeral Home, Wolcott, Connecticut; Charlie Eagan, Greenwood Funeral Home, New Orleans, Louisiana. This is in the SCI package.

Charlie is on fire entrepreneurially, and what he is doing in New Orleans with our other team players over there is nothing short of a minor miracle that we expect over time to turn into a major miracle. Thank you, Charlie.

Ben Friberg, Heritage Funeral Home, Fort Oglethorpe, also a relatively new acquisition from December of last year. Way to go, Ben. A repeat high performance award winner from the second quarter.

Fred Bryant, Bryant Funeral Home, East Setauket, New York.

In the central region, Brad Shemwell, Latham Funeral Home, Elkton, Kentucky; Andy Shemwell, his brother, Maddux-Fuqua-Hinton Funeral Home, Hopkinsville, Kentucky; Kyndall Hale, Don Grantham Funeral Home, Duncan, Oklahoma; Kyle Incardona, Hillier Funeral Home, Bryan, Texas. That's Texas (A&M) where we're building a fantastic new facility. Jeremy Sparks, Rest Haven Funeral Home, Oklahoma City, Oklahoma; Jeff Moore, Sterling-White Funeral Home, Crosby, Texas.

Western region, Steve Mora, Conejo Mount Cemetery, Camarillo, California and Funeral Home; Nicholas Welzenbach, Oak View Memorial Park Cemetery, Antioch, California; Ken Summers, PL Fry and Son Funeral Home, Manteca, California. And finally but not least, Adam Mills, Johnson-Gloschat Funeral Home, Kalispell, Montana.

These are operating businesses. These businesses are supported by teams here in our home office and one of the most important teams that are critically important to the support of this model and framework are the operational analysts in the home office. And I would like to call out a high performance winner from that group, Peggy Schappaugh.

Peggy is the analyst for our western region. She has been here a long time. She is seeing a lot of evolution in this progress, and she is a complete homerun winner.

Thank you, Peggy.

With that I'd like to close the call and open it up for questions.

Operator: Thank you. Ladies and gentlemen, if you have a question at this time, please press star and the number 1 on your touchtone telephone. If your question has been answered or you wish to remove yourself from the queue, please press the pound key. And once again if you have a question at this time, please press star and the number 1.

Our first question is from Alex Paris with Barrington Research. Your line is open.

Joe Jansenn: Good morning, gentlemen. This is actually Joe filling in for Alex.

Bill, let me – you kind of listed off eight points and I was taking notes and trying to get it all so I apologize if I don't have all the details. But first, let me – let's talk about the SCI properties. In your comments it sounds like they're performing better than they did on a sequential basis. I'm just curious maybe how that compared to you, what your expectations were. And then also maybe, you know, what you're hearing on the field level, you know, as you've integrated these new employees kind of, you know, what – you know, how they're operating under the kind of Carriage umbrella. I know you guys are the – you know, the consolidator of choice, I'm just curious what message and what you're hearing from them.

L. William Heiligbrodt: Well, let me answer part of that, and I'll let Mel answer part of that. As far as the operations themselves, as far as the numbers are concerned, if you look at the second quarter you'll see acquisition revenue up 30 percent and you'll see field EBITDA up 50 percent.

And then I commented in my points, if you take that forward one quarter you'll see acquisition revenue up 50 percent and field EBITDA up 70 percent. So translating that into the numbers on a very, very conservative basis, I raised a very good or any increased number of 22 cents per share to 23 cents based on those numbers alone.

So what we have right now, looking at my estimations which are all a somewhat conservative, but I think based on where we are today with the New Orleans acquisitions basically put into a real perspective is we're out at our 2015 numbers already. So it's really performing quite well, and we're very, very happy with everything. So I think that kind of gives you a basis of how we feel that is, OK.

Mel Payne: This is Mel, Joe. We picked these two markets and the packages in these markets for a reason. This – in particular, New Orleans was the home office of Stewart, their home base. And so that market have been highly consolidated by various consolidators over 30 years – 40 years. Stewart was only one of them.

Loewen came in as they no longer exist, they turned into Alderwoods. SCI bought them and they bought Stewart. So you had SCI, Alderwoods or Loewen, and then you had another big independent from Louisiana that was a big consolidator. And you have Stewart, so you really had huge consolidation and a lot of stuff moving around over 30, 40 years, and a lot of market share moved around.

And then in the middle toward the end of that, you had Katrina which moved around some stuff. So you really had a market in – there's no other market that I don't like. Let me put it that way. So all they knew was the model of market management. Our model is the opposite of overall market management.

We don't have market managers. What we did is take these four businesses and in three of them, we had inserted entrepreneurial leadership. We converted the other one who already was there into an entrepreneur, and then we started moving over people who could bring business – market share because they had followings and were with the other companies.

What we have accomplished in a short amount of time like six months has been – has been shocking to those who know the market and live in the market and who have been in the business for all these years. But if you really want to know what's going on over there, you ought to get the names of our managing partners and their telephone numbers, call them and ask them because we have nothing to hide.

And I will tell you the future based on what we modeled out is going to look a lot better than that over the next two, three, four, five years. We're investing another $4 million in these facilities to fix them up. And we fully expect the performance to be driven by a combination of market share moving from wherever it is now over where we are now following the people we brought over there now. And as they bring in more volume in a high fixed cost facility you're going to see the profit margins go up. And in our view, these four businesses have been over-managed for short-term profit.

We won't earn quite as high margin over the time like they were earning before. It will be totally within the framework of what we find high and sustainable. But what you'll find it will be very difficult to model-out the success we expect over the next five years. It's going to be better than you can model, and that's why it's exciting.

We just did – we went through this yesterday, and I wanted – I wanted Bill to take notes. He did. Our people gave a report on every business, what's going on, because over the next six months, year, two years he's going to have that to show investors how this works when you do it right and to say we are excited about these two markets will be an understatement. It's going to be fantastic.

Joe Jansenn: OK.

Mel Payne: But if you want those numbers and column, we'll give them to you.

Joe Jansenn: I might take you up on that. I appreciate it, Mel. I'll do that offline.

Mel Payne: That's where you're going to learn the most. You're not going to learn it from me or Bill.

Joe Jansenn: And then, Mel …

Mel Payne: Maybe more from him than me.

Joe Jansenn: … on your prepared remarks you talked about last three months you and Dave, any corporate development, things like that. I'm just curious. Are you changing assumptions in your strategic acquisition model in terms of the overall funnel? We know that it's a fragmented market. We know of that. You've kind of looked – you know, you kind of had your target. Has that restricted the targets or has that kind of directed you into a different direction? I'm just curious when – your comments, what you made, you know, kind of what that entailed.

Mel Payne: Now what – I'll give an example. We're profiling strategic markets that we identify as having a lot of targets, remaining independents, high quality independents, large markets. So if you go in and buy a really good one, a number one or a number two, it gets the attention of all the players in and around the market.

Let's say in around New York City, Long Island, New Jersey, South Jersey, up in the Connecticut and around Hartford, Pittsburgh, there is not much consolidation in Pittsburgh. There's some really good businesses in Pittsburgh. And so we're going to profile the whole market, profile every business in the market. That didn't mean they're all sellers. We'll build relationships with them over time.

And when we go in we'll do it with a top-notch business and the industry is very clubby known by the company you keep. So when you – when you affiliate with the top one it gets everybody else's attention. So we'll do that in Pittsburgh, we'll do it in and around New York where we already have a high presence and around Boston, down the East Coast through – in and around Washington, Virginia, North Carolina where the averages are good. The cremations are still relatively on the low side so you get high revenue and you get high margins.

And, you know, we're going to stay away mostly from the commodity markets. But in some of those markets you can find individual really good businesses like the Florida Panhandle.

We like parts of California and in and around LA. We want to grow some more. So these – we want to focus, focus, focus, focus. We're not out to buy something just because it might be an individual good business in the middle of nowhere.

Joe Jansenn: OK. Let me ask one more question. I'll jump back in queue. I know this is your guidance, this is your goal. You mentioned $1.90 to $2 per share in your prepared remarks so on the press release. Just a clarification, is that the 2016 earnings per share or is that at the …

Mel Payne: No, that's the annualized …

Joe Jansenn: Rolling four quarters forward, right?

Mel Payne: At the end of 2016, that ought to be the four-quarter outlook roughly in and around …

Joe Jansenn: OK.

Mel Payne: … roughly range.

Joe Jansenn: OK.

Mel Payne: That's our goal.

Joe Jansenn: Right.

Mel Payne: I wouldn't be saying it publicly. We didn't take it seriously however.

Joe Jansenn: OK. Good job, guys. Thanks.

Operator: Thank you. Our next question is from Alan Weber with Robotti & Company. Your line is open.

Alan Weber: Oh, good morning.

Mel Payne: Alan, where have you been?

Alan Weber: I've been around the year. So a quick question on the rolling four-quarter outlook. When you include in that consolidated EBITDA, how much is that – I forgot now, how much of that is from acquisitions for – you know, that you're going to complete as opposed to what's already been completed?

L. William Heiligbrodt: It's very, very small, Alan. And really I mean, technically, we're looking at now there's some acquisition benefit in the third quarter of 2015. So pretty much up until the end, we don't have very much.

As you know, and we've talked to you before, generally as we talk about what we're going to do we have some very, very low numbers that we have included before in that number, something in the range of maybe spending as much as $40 million a year. So when we look at this particular one since we have already spent $54 million and we have a benefit of new acquisitions coming in through June of next year there's very, very small amount in that number.

Mel Payne: Let me comment on that, Alan. You know, a long time ago, I got on the treadmill of the quarterly estimates and annual estimates, and I learned to regret it. So we don't do that. So the third rolling four-quarter outlook is a rough range that we expect to be in because when you include acquisitions you don't know when they're going to close. You can't make the decision for them when they want to exactly sell.

We're totally satisfied that we will achieve the acquisitions that Bill talks about. But when they close and how much performance they contribute within that period is very difficult to predict. And that's why we went to rolling four quarters that are roughly right ranges.

The concept here is that the company is executing operating and strategic growth models that are creating earning power – more earning power as we grow, leveraging the overhead, leveraging the capital structure, getting businesses that can grow organically so you got the operating leverage. So overtime I am totally confident that the earning power within a range of being roughly right will be what we put out there, but it's not an estimate.

Alan Weber: OK, great. No, I was asking because if you look at the growth of EBITDA, well, it's kind of – if you look at the growth of EBITDA relative to the acquisitions and capital spending it shows that, you know, obviously the acquisitions are accretive and you are getting the return because actually it seems like the only way, as an outsider, to really measure that.

Mel Payne: The acquisitions that we will be doing – and we have improved our methodologies, we're doing more due diligence upfront. When we – when we close an acquisition – this will include the next one – we will have, before we close it, a specific integration plan. It's what we call it. And that specific integration plan will be all the changes that are necessary to be made in that business, which ought to be a good business to begin with so that it will be operating at a high level of standards achievement within three months. So these businesses that we're buying will turn accretive. If they're not already accretive, they want very fast.

Alan Weber: OK, great. Just on a side question, I know you talked earlier about the refinancing and the rate on the – on the new convertible, and in hindsight, Mel, since you talked about the stock price, you know, in a general way now, in retrospect would it have been better off just having a slightly higher yield and not having that future dilution for the number of shares?

L. William Heiligbrodt: No. It's Bill. Because of the way the dilution comes in on that convertible and the cost of that convertible versus – and what we could raise in that market versus the acquisition of the SCI properties, we – probably that's a little bit longer discussion than we got here, but I'd be happy to go – Robert and I will be happy to go over that with you. I think you'll understand it completely.

Alan Weber: OK.

Mel Payne: On that point, Alan, that's a huge point because I don't know whether that have been a concern that's hanging over the stock price right now or not. But the way that then works is very unusual because there's a future in there that Bill and Robert negotiated so that you don't get all that dilution. You can actually settle that convert whenever the holders want to with mostly cash. And they can't – they can't force you into stock, so the dilution is not exactly the simple math would lead you to believe it might be.

Alan Weber: OK, great. I have to look at the indenture. Thank you.

L. William Heiligbrodt: We'll call – we'll call you back, Alan.

Mel Payne: I think there's been some confusion on that.

L. William Heiligbrodt: Robert and I will call you back to discuss that with you in detail.

Alan Weber: OK, great.

Mel Payne: I think that's an excellent point, Alan. And I think you've – I think we need to do a better job of explaining that.

Alan Weber: OK, great. Thank you very much.

Mel Payne: Thank you for your support all these years.

Operator: Thank you. And I'm not showing any further questions.

Mr. Payne, please proceed with any closing comments.

Mel Payne: I think we covered it all. We appreciate everybody who called in. We appreciate your interest. We have a great company and it's getting better. That's the best part. We look forward to reporting our full-year results sometime in January. Thank you very much.

Operator: Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day.

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