CARRIAGE SERVICES, INC.

Moderator: Chris Jones
May 8, 2014
10:30 a.m. ET

Operator: Good day, ladies and gentlemen, and welcome to the Carriage Services first-quarter 2014 earnings webcast 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 this conference please press star then zero on your touchtone telephone to reach an operator.

As a reminder, this conference call may be recorded. I would now like to introduce your host for today's conference, representing Carriage Services, Chris Jones. Please go ahead.

Chris Jones: Thank you, Charlotte. Good morning, everyone. We're glad you could join us. We'd like to welcome you to the Carriage Services conference call. Today we will be discussing the Company's 2014 first-quarter results, which were released yesterday after the market closed. Carriage Services has posted the 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 replay of this call will be made available and active through May 12. Replay information for the call can be found in the press release distributed yesterday.

Speaking on the call today from management are Mel Payne, Chairman and Chief Executive Officer; and Bill Heiligbrodt, Vice Chairman. 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 the 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 for 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. Well, we've been busy. Very busy over the last six months working on a handful of major areas previously announced in our March 5 press release. And updated in our first-quarter release yesterday that would position Carriage for even greater success in the years ahead than we have achieved over the last two years since we initiated our five-year Good To Great Journey.

The most important of these areas is a leadership matter. With the addition of Dave DeCarlo to our executive officer team, which is now comprised of Bill, Dave, and me, operating together more like executive partners in the form of an executive committee responsible for all aspects of our Company, consistent with our 2014 theme, One Team, One Vision.

It is truly an honor for me and Carriage to have Bill and Dave as partners on this Good To Great Journey, as each has a history in and knowledge of the industry based on experience that could not be found anywhere else. And is unique for a company our size.

I will now turn the call over to Bill to provide some color commentary on our first quarter performance. After which Dave will introduce himself and make a few comments. Bill?

Bill Heiligbrodt: Thank you, Mel. Again, I'm going to say while this press release really provides a detailed report of our first-quarter performance, I'd like still to comment on a few of the components therein.

First, I'd like to start with earnings per share and performance margins. Adjusted earnings per share for the quarter was $0.30 per share, compared to $0.33 in 2013, a decrease of approximately 9%.

Performance margins, however, remain very high. I'd like to put that into perspective by putting and comparing those numbers to the full year 2013. Field EBITDA margin was 40.9%, compared to 39.5%. Adjusted consolidated EBITDA of 27.1% compared to 26.2%. And adjusted net profit margin of 9.6% compared again to a full year 2013 of 8.5%.

The main reason for the decrease in earnings per share was a 6.5% decrease in same-store funeral volume, compared to the first quarter of 2013. In essence, as we have said many times, funeral business cycles tend to run and tend to exceed 90-day period.

And as we look back to the first quarter of 2013, we are comparing against very high and unusual numbers in same-store volume. In fact, these numbers were as high as I can remember during my career in this industry.

Now, as we move to the second, third, and fourth-quarters for 2014 and to a more complete business cycle, we will and should see these comparisons even out and become easier and more approximate the 2013 comparison of same-store funeral volumes versus 2012 of flat to up slightly.

In fact, we were up 2/10 of 1% for 2013 in same-store funeral revenue comparisons versus 2012. Also, I would like to mention that in our rolling four-quarter projection of $1.18 to $1.20 per share given to you on March 5, we internally were expecting a number for the first quarter of $0.28 a share. Therefore, we slightly exceeded those expectations.

Now, I would like to look to the remainder of 2014. First, we completed and announced the refinancing of our convertible debt on March 13. Because of very large demand for these new securities, we were able to issue $143.8 million in new convertible subordinated notes for 2 3/4% with a seven year maturity, and conversion of 32 1/2% at $22.56.

These convertible notes replaced $90 million of junior subordinated debentures that carry a 7% interest rate. The full financial benefit from this transaction will not begin until the second quarter, as there was a 30-day call period involved in removing the old notes.

Second, with the closing of the new convertible subordinated notes, we negotiated a new expanded bank credit, increasing from $242 million to $325 million, with a new maturity of five years. This was accomplished with no increase in cost of financing to Carriage.

Third, with the new financing we will be able to complete the purchase of six businesses from Services Corporation International for slightly more than $50 million. The due diligence and integration process for this transaction has been at least a six-month serious time period and represents an amount that exceeds what we have said we would like to complete in acquisitions annually. These acquisitions probably will be approved by the FTC as early as next week, with completion within the next week after FTC approval.

Finally, after all this, we will have our free cash flow from future years plus slightly more than $150 million of available bank credit to finance a continuing acquisition and growth investment program for our shareholders.

In summary, looking to the remainder of the year 2014, first, we should see better comparisons in same-store volume in the second, third, and fourth quarters. Second, the new financing will lower our cost of capital and are very accretive in interest differential alone.

Third, we are completing a meaningful acquisition of six businesses that will be very accretive to Carriage in 2013 and 2014. All of the aforementioned benefits begin where we are now in the second quarter.

Concluding, then, with this summary we are increasing our rolling four quarters outlook ending 3/31/2015 to $1.25 to $1.31 per share. Our future looks very bright. Thank you.

Mel Payne: Okay, Dave.

Dave DeCarlo: Thank you, Mel. First, I'd like to thank you, Mel, for providing me with the opportunity to be on the Carriage Board three years ago. And then the opportunity to join the Company full time as an employee in March.

I'm excited about being an employee of Carriage because based on my over 30 years of experience in the industry, including three years of experience with Carriage, I cannot think of a better company in this industry that has such potential to increase shareholder value.

I also consider it an honor to be working alongside you and Bill, two industry icons, in my eyes. And so it's great to be a part of the executive team. And I'm looking forward to working with you.

Mel Payne: Thank you, Dave. I think with that we'll just turn it over for questions.

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

Our first question will be coming from the line of Alex Paris from Barrington Research. Your line is open. Alex Paris, your line is open.

Alex Paris: Can you hear me? OK. Thank you. Morning. Congratulations. Mel, my first question is for you. With Dave DeCarlo joining the Board, or joining the Company in the executive – as a part of the executive management team, how will responsibilities be divided among the three of you going forward?

Mel Payne: Well, we formed an executive committee. I put out a press release on March 5 that touched on it a little bit. Internally, it was much more complete about how the Company will be organized.

And the way it will be organized is Bill and Dave and I are an executive officer committee. We have a small group that includes our three regional partners; that's operations, sales and operations.

We have the heads of two or three maybe four of our key support departments including operational analysis and planning. And also acquisitions, corporate development and maybe one or two other key support department heads that are on this team. We call it Strategic Growth Leadership and Operations Team. And it's about eight people with Bill and I and Dave co-chairing that group.

So the way the Company will be operated is we'll all three be involved in key operating strategies and decisions, in key acquisition strategies and decisions as one team going along with the idea of One Vision.

It's very clear we're very small. We all are on one floor, one end of the floor. So this is not some layered bureaucratic organization. And the key to Carriage is the collaborative high-performance culture. And anybody here can call a meeting, Bill, Dave or me or any of the members on that team, about operations, acquisitions or anything else at any time.

And it's a heck of a lot of fun to come to work when you have a dynamic, collaborative coordinating group like that getting stuff done fast and effectively. And that's how the Company's going to be run.

Alex Paris: Great. Well, welcome aboard, Dave. I look forward to meeting you.

Dave DeCarlo: Thank you.

Alex Paris: Moving on, the – your earnings results, though down year-over-year as expected, were better than my estimate. Revenues were a little below and it was not because of same-store sales. I think that was well communicated. They actually did a little better than I had thought.

Where the variance was on my estimate was acquisition-related revenue. I was a couple million dollars too high on that. Excluding the pending closing acquisitions on SCI, what sort of number are we going to get in terms of a contribution from acquisitions in 2014? Just ballpark, that would be helpful.

Bill Heiligbrodt: Well, it's obviously we haven't closed anything yet. And we haven't operated anything yet. Taking that into consideration, there's a combination of benefits ha – whether you take the interest differential benefit or whether you take the acquisition by itself.

The combination of the two is for the remainder of the year we think is probably in excess of $0.10. Probably more like $0.13. And again, this is pure speculation when we haven't closed the transaction.

The SCI transaction alone as it stands with the new financing for the remainder of the year could be – would be probably in excess of $0.06 a share.

Mel Payne: Alex, this is Mel. I would – and Bill's talking about the acquisitions to be made. Right? And we do have a good pipeline in addition to the SCI divestitures. But the existing group of acquisitions that have been made over the last five years, which is how we report it rather than one year same-store, if you'll notice in the quarter the really good news was the field EBITDA margin for that group was the highest in several years.

So we had some businesses in the acquisition group, maybe a couple, under-performing last year, which we don't expect to be the case this year. And the new one we added in November last year started off humming and is getting better.

So I think what you'll see both from the existing acquisition portfolio and new acquisitions, including the SCI, is very material.

Alex Paris: Great.

Bill Heiligbrodt: Let me add to that just a little bit, Alex, because I looked at the numbers because I read your reports. And the $2 million where you're off is on acquisitions.

Since we have a five-year group of acquisitions it was in the earlier acquisitions. The latter acquisitions completed in 2012, 2011, even 2010, were pretty much performing very well. And in fact, some of the acquisitions in 2012 had margins over 50%.

Mel Payne: Yes, I agree with that. It's just that as a group we've never been this close on our same-store field EBITDA margin. And our acquisition portfolio margin. It was very close. And over time, and I don't mean a lot of time, we expect the acquisition portfolio margin to exceed it.

Alex Paris: Great. And then with regard to the SCI acquisitions, obviously those six acquisitions and the revenue that will come with them exceed the target that you've set for yourself on an annual basis.

Should we expect you to be active in making additional acquisitions over the balance of this year? And then if so, is anything imminent on that front?

Mel Payne: You want to speak to that, Dave?

Dave DeCarlo: Well, we have a very nice pipeline, I'll say that much.

Mel Payne: The answer's yes.

Alex Paris: Okay. So you will be in the market making other acquisitions this year outside of the SCI. And then was the answer yes to imminence, (inaudible) also?

Mel Payne: I would say not imminent. We've, like Bill said, this has been all hands on deck to get this group. Because we want it to hit – we want the SCI divestiture to hit the ground.

Bill Heiligbrodt: You guys have to remember, this acquisition is coming from consolidators. It's not like we're consolidating a mom and pop operation where we have real, real firm feeling on what exactly everything is.

There's difference in policies, people, everything that has to be reconciled. And for me, having been involved, again, in this industry for quite a period of time, the amount of effort that has gone into making this right has been monumental. And I can certainly speak to that.

That doesn't mean we've lost forecast in terms of what we're going to do elsewhere, because that's the life blood of our growth scenario. However, to do these acquisitions right as we've done in the past, it's a 90-day process.

So when you ask us imminent, I don't know whether you're talking this year, six months, three months. If you're talking this year, I think there'll be some additional acquisitions possibly closed this year.

If we're talking the next 90 days, I mean, our focus is still on the integration policy in Carriage of a company that has never recently done six acquisitions all at once and completed it in one day.

As you remember, the 2012 list was over a period of time. So we want to make sure that we continue the record we have of making these acquisitions right, doing them right and having them accretive the first day.

Mel Payne: These acquisitions, Alex, are in big markets. And one of the attractive things to us has been to put our framework on these businesses individually. And really get the people involved, excited about a totally different way of operating.

With the idea that, look, right out of the gate we want highly motivated leadership and employees trying to win the battle of market share, hearts, and minds in those big markets where there is a lot of market share to capture from primarily SCI, who – that's the reason they're selling them.

So we're very excited about the upside. We want to make sure we grab it sooner rather than later. And that requires a lot of planning and very intense work within the businesses. So we are ready. And we are also now really turning our attention to the pipeline and getting some of those closer to signing up. But it – I think we'll make more acquisitions this year.

Alex Paris: Great. And then I guess the last question relates to trust fund earnings. In 2012, there were some big gains taken as a result of some timely trades made during the financial crisis. I don't believe there was a significant contribution in 2013. And I don't expect a significant contribution in 2014. These earnings are primarily from operations.

Mel Payne: Well, I'm involved heavily in the trust. And –

Alex Paris: Right.

Mel Payne: Our trust funeral earnings are increasing. But that's primarily because we took so many gains over the last five years that that gets pushed down to the individual contract.

And then you have recurring revenue and income off dividends and interest on our large fixed income portfolio. Where we were lower in this particular quarter was the cemetery trust.

But I wouldn't say that that will continue to be at that level. I think it probably will go up. We have some large unrealized gains in our portfolio again. So we're waiting to harvest those.

Bill Heiligbrodt: And I might say that in our forecast that we've talked about (inaudible) in our rolling four quarters that we've taken there. Our numbers are essentially maybe slightly up. But certainly at least flat on our – as far as our investment funds. So there'll be no detriment to the financial earnings of the Company.

Mel Payne: What you're seeing here is the reported GAAP earnings through the trust.

Bill Heiligbrodt: That's right.

Mel Payne: But what you don't see is we did outperform both the fixed income market and the equity market substantially in the first quarter. And we do have a fairly large amount of unrealized gains.

Alex Paris: So let me just ask one more related question to that, then. And, Bill, since you brought it up, based on your forward four quarters, $1.25 to $1.31, how much of that EPS is a result of trust fund earnings?

Bill Heiligbrodt: It's comparable to what it was in 2013. It's not increased.

Alex Paris: Okay. Which was roughly?

Bill Heiligbrodt: Whatever it was. I don't have it in front of me. But the numbers are virtually what I said, flat, slightly up. And I'm thinking –

Alex Paris: Okay. So none of the growth is coming from trust fund?

Bill Heiligbrodt: No. No. It's all coming from pure operations.

Mel Payne: We had $18,774,000 in financial revenue. That's the four measured components in the funeral – no, I know. And then that converted into financial field EBITDA of, let's see, $17.3 million. And what Bill's saying is that we expect this year to be about the same.

Bill Heiligbrodt: That's correct. And if I had to guess just based on what I'm looking at here in the Company today, there's probably some room for benefit there. We just didn't push that into any of our numbers.

Alex Paris: Good. Okay, that's very helpful, guys. And great quarter despite the tough comp.

Mel Payne: Thank you, Alex.

Operator: Thank you. Our next question will be coming from the line of Clint Fendley from NewBridge. Your line is open.

Clint Fendley: First question just wondered your all's thoughts on free cash flow for this year. I know you expect to become a small cash taxpayer this year. How do you think that will impact your growth here after you factor in the SCI acquisitions?

Bill Heiligbrodt: I'll try to take a whop at that. One of the things that happened in the – as you remember, is that we took out early an option which had a cost to the Company. Obviously, we saved about $4 million for the Company in that transaction.

And we removed about 1,600,000 shares of potential problems. Dilution. So in doing that we created a large tax benefit. And that tax – that's part of the main – that's the main entry that's in the cash flow statement. It's kind of an accounting entry.

But you have to understand in that we didn't have enough income in the first quarter to offset all of the tax benefit. Therefore we created deferred income on our financial statement. As we go through the year, and our earnings build come through on a quarterly basis, we'll be taking that tax benefit so that cash is going to come back to us on a quarterly basis as that tax benefit is realized.

So that's very favorable. But to sum it all up on everything, Robert and I – Prescott, who I think most of the people on the call are familiar with – have studied this and studied this with our accounting people for the last three days.

We're very confident that our cash flow for the year is going to be somewhere in the range of minimally $35 million to $38 million.

Clint Fendley: Okay.

Bill Heiligbrodt: Free cash flow. Excuse me. After maintenance CapEx. I'm sorry.

Clint Fendley: The free cash flow. Okay.

Bill Heiligbrodt: Right.

Clint Fendley: That's really helpful. A question on the guidance, too. I know your – the rolling four quarter outlook has about $4.7 million in special charges in there.

And I think that's about $0.25. Is – any color or detail just for what those – what's in those charges?

Bill Heiligbrodt: Yes. It's all pretty well identified there. Most of it, Clint, is – that has to do with the restructuring of the debt. Restructuring of some of the compensation issues here. They're all – and terminations which are all one-time charges.

Basically, that's the sum of it all. So it is – it's basically totally non-recurring – huh?

Mel Payne: The SCI divestiture.

Bill Heiligbrodt: Yes.

Clint Fendley: Okay. No, that's –

Bill Heiligbrodt: So –

Clint Fendley: – that's helpful, then.

Bill Heiligbrodt: It's one-time charges. Basically we had to write off old charges that we were accruing on the old notes. All that was written off. This – one – the biggest charge in there is what we're talking – I guess on these deferred charges and so forth.

Some of it is how you bring in the new converts from the accretion value. That has a value that we eliminated, put into the adjusted basic earnings. So that – because it's all one-time charges. And that's all we're trying to do there is give the shareholders a really good look at the Company on what recurring income is.

Clint Fendley: Okay. And a last question. I wondered on your variable overhead, that was up a little bit in even a year-over-year. Any detail on why that was up? (inaudible) think it will stay here at these levels throughout the remainder of the year?

Bill Heiligbrodt: No, I don't think so. And some of that overhead that was up – that shows up in variable overhead was eliminated in the one-time charges.

So I think the over – if we look at a history of the overhead, I look back to the first quarter, the overhead was – there was some expansion in the first quarter of overhead last year.

After that, the concerted effort to make a real effort to reduce that corporate overhead, which has been accomplished. And if anything, I think that number is going to probably trend a little down.

Clint Fendley: Okay. Good to hear. Thank you, guys. I appreciate the help here.

Mel Payne: Once you do all those add-backs, Clint, I think it's only a couple hundred thousand year-over-year.

Bill Heiligbrodt: Right. Flat.

Mel Payne: It's flat.

Bill Heiligbrodt: And going down.

Mel Payne: And going …

Clint Fendley: It's flat. Headed down. Okay, well, that's what I thought, given some of the cost cutting that you all had done here in the last few months. But I just wanted to make sure that that was the case.

Mel Payne: But it was.

Clint Fendley: Okay. Thank you.

Operator: Thank you. And as a reminder ladies and gentlemen, if you have a question at this time, please press star then the number one key on your touchtone telephone. Again, if you have a question at this time, please press star then the number one key on your touchtone telephone.

Our next question will be coming from the line David Woodyatt from Keeley Asset Management. Your line is open.

David Woodyatt: Okay. In going through the press release, there's a couple of different tables that show the difference between GAAP and adjusted earnings per share. The tables don't seem to (inaudible).

I think the problem is on, I think it's page 6 of the press release. Or at least the copy I have. In the table that appears above the balance sheet. If you take a look there at the lines that show the last five quarters of GAAP and adjusted, I think those numbers are reversed.

Could you look at that? Maybe you could answer other questions while you're doing that. And then get back to this issue.

Bill Heiligbrodt: We have our front – our senior accounting officer with us here. I'm going – she's going to look at that right now.

David Woodyatt: Yes. Why don't you go ahead and answer some other questions, then. I don't have any others.

Operator: All right, thank you very much. And as a reminder ladies and gentlemen if you have a question at this time please press the star then the number one key on your touchtone telephone. We'll wait to see if we have any further questions.

Bill Heiligbrodt: David, I think – if you're still on the phone, we'll call you back on that particular point after we have a chance to thoroughly research that to be sure. I'd rather do that than trying to do it here while we're thinking about this call. Okay? And we will get right back to you.

Mel Payne: With that, I'd like to wind up the call by saying a few comments that I normally say on the front end of our calls. To be honest, this is the favorite part of my call.

We just returned from our annual rewards trip which we call Being-the-Best Pinnacle trip where we have our best performers and their spouse or partner for four days together. And by the time we leave that trip, it's more like family.

It has a lot to do with leadership in the Company of high performance results. And really recognizing those kinds of performances over time. I would like to announce our first-quarter high performance heroes.

In the Central region, there's Jeremy Sparks, Resthaven Funeral Home, Oklahoma City. Rick Berardinelli, Berardinelli Family Funeral Service, Santa Fe, New Mexico. Mark Ratliff, Carman and Robertson Funeral Homes in Flatwoods, Kentucky. Johnny Garcia, Ceballos-Diaz Funeral Home, Edinburg, Texas. Shane Ritchie, Beard Mortuary, Huntington, West Virginia. Brad Shemwell, Latham Funeral Home, Elkton, Kentucky. And Kyle Incardona, Hillier Funeral Home in Bryan, Texas.

In the East region, Robert Maclary, Kent-Forest Lawn Funeral Home in Panama City. Chris Duhaime, Funk Funeral Home, Bristol, Connecticut. Tom O'Brien, O'Brien Funeral Home, Bristol, Connecticut. Ben Friberg, Heritage Funeral Home and Crematory, Fort Oglethorpe, Georgia. And Curtis Ottinger, Heritage Funeral Home in Chattanooga, Tennessee.

Both Ben and Curtis were with our most recent acquisition. Congratulations. Andrew Cumby, Cumby Funeral Home in High Point, North Carolina. Fred Bryant, Bryant Funeral Home, East Setauket, New York, Long Island. And Jim Terry, James J. Terry Funeral Home in Downingtown, Pennsylvania. Quite a few of these were from the 2012 alumni association Bill mentioned earlier in these.

West region, Justin Luyben, Evans-Brown Mortuary, Sun City, California. Richard Munoz, Connelly & Taylor, Martinez, California. Kristi AhYou, Franklin & Downs Funeral Homes, Modesto, California. Michael Nicosia, Ouimet Bros. Concord Funeral Chapel, Concord, California, and San Ramone Valley in Danville. James Schmerer, Alsip & Persons Funeral Home in Nampa, Idaho. Last but not least, Jay McDaniel, (Westcon Forcasta), Richmond, California.

That's 21 high performance heroes in the first quarter. Five of those just returned from the Pinnacle trip in California. So that means 16 from this list who did not achieve Pinnacle status last year. I'm quite sure as you go through the year we'll have more high-performing heroes. And I look forward to calling out their names and recognizing them. And with that, I'd like to end the call. Thank you very much.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone have a nice day.

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