CSV – Q1 2016 CARRIAGE SERVICES, INC. EARNINGS WEBCAST

APRIL 26, 2016 | 9:30 A.M. CT

CORPORATE PARTICIPANTS

Viki Blinderman *Carriage Services Inc. - Co-Chief Financial Officer and Chief Accounting Officer*

Mel Payne *Carriage Services Inc. – Chief Executive Officer and Chairman of the Board*

Ben Brink *Carriage Services Inc. - Co-Chief Financial Officer and Treasurer*

CONFERENCE CALL PARTICIPANTS

Greg Charpentier *Oppenheimer - Analyst*

Chris McGinnis *Sidoti - Analyst*

Alex Paris *Barrington Research - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Carriage Services First Quarter 2016 Earnings Webcast. At this time, all participants are in a listen-only mode.

(Operator Instructions)

As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Ms. Viki Blinderman, with Carriage Services. Ma'am, you may begin.

Viki Blinderman - ***Carriage Services Inc. - Co-Chief Financial Officer and Chief Accounting Officer***

Thank you and good morning, everyone. We are glad you can join us today. We'd like to welcome you to the Carriage Services conference call. Today, we'll be discussing the Company's results after the first quarter, which was released yesterday after the market closed.

Carriage Services has posted the press release, including supplemental financial tables and information on its investor's page on our website. The audio conference is being recorded and an archive will be made available on our web site. Additionally, later today, a telephone replay of this call will be made available and active through April 30. Replay information for the call can be found in the press release, distributed yesterday.

On the call today from management are Mel Payne, Chairman and Chief Executive Officer, and Ben Brink and myself, Chief Financial Officers.

Today's call will begin with formal remarks from management, followed by a question-and-answer period. Please note that during the call, we will be making 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 these statements, which are more fully described in the Company's report filed on Form 10-K 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 this date of this call to reflect the occurrence of events, circumstances or changes in expectations.

In addition, during the course of the morning's call, we 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 and on our website.

Now I'd like to turn the call over to Mel.

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

Thank you, Viki. I won't say a whole lot upfront; I said most of what I had to say in the press release and especially in the shareholder letter, which if you haven't read it, you really should if you want to be an investor in our company.

I do want to say that Dave DeCarlo would have been here, but he had a family emergency and could not be here, although he is on the call today. So we wish he and Peggy the best as they deal with that emergency.

And in that regard, I just want to compliment Dave and Michael Cumby with the kinds of activity they have growing across the industry to tell the story of Carriage. We are going to close on a wonderful business in the next couple of months in a wonderful market; two locations, very strategic, very large. The wonderful business will become a bigger wonderful business, as part of the Carriage family over the next 5 or 10 years. It will turn a few heads when it happens and it will be a reputation builder, which is one of the things we look for when we do anything.

So, I congratulate Dave and Michael on what they are doing; there is other activity in the pipeline. We don't want to forecast that, although I'm sure this year we will do some other acquisitions that will be the right ones at the right time, and will be mutually beneficial over a long time.

Now as far as upfront comments; this quarter was probably a statement for us about just how good our company has become at operating. Because everything in the industry I'm told was negative in terms of volumes, new flu season, world is coming to an end. Well, it reminds me of a metaphor that Warren Buffett, and if you read any amount of material, you know I've studied him a lot, uses about the market. And when there is a rising tide of liquidity flowing into a market, it makes all the boats rise. But, when the tide goes out, turns out there have been a lot of boats leaking and a lot of swimmers with no bathing suits on, swimming naked.

This was a quarter where the tide went out for our business and yet we had a record quarter. So it just shows that, broadly speaking, our Managing Partners and their employee teams under the framework of Carriage, executing a Standards Operating Model, took no prisoners. It speaks to the idea that we had a long time ago about Carriage; someday we will be so good at what we do, broadly, that it will look like we're in a different industry. I think the first quarter looks like we're in a different industry.

With that, I'll turn it over to Ben for more color.

Ben Brink - ***Carriage Services Inc. - Co-Chief Financial Officer and Treasurer***

Thank you, Mel. Our first quarter operating and financial results marked another record setting performance for Carriage. In a tough funeral operating environment, we achieved record quarterly revenue of $63.3 million, record field EBITDA of $27.7 million, record Adjusted Consolidated EBITDA of $19.9 million, record Adjusted Consolidated EBITDA Margin of 31.4% and record Adjusted Diluted Earnings per share of $0.47, a 12% increase over first quarter 2015.

Our Adjusted Free Cash Flow continued to increase to $11.7 million in the quarter. We experienced a challenging funeral operating environment in the first quarter with same store funeral contracts down 5.4% and total funeral contracts down 3.2% versus 2015. Despite the decrease in call volume, the execution of our Standards Operating Model by our Managing Partners and their employee teams across the company was extraordinary with total funeral revenue only down 1.4% and funeral field EBITDA down less than 1%.

We've spoken often about the operating leverage that is inherent in the funeral business and that leverage can work against you in a weak call volume environment. Given this backdrop it is equally impressive and a testament to our Operating Teams that Total Funeral EBITDA Margin increased year over year to 41.2%.

Our cemetery operating performance continued to demonstrate the momentum we have seen in the business over the past few years with revenue increasing $750,000 or 6.8% and Cemetery Field EBITDA increasing 5.6% compared to the first quarter of last year. Financial Revenue and EBITDA were essentially flat year over year.

Throughout the first four months of the year we have executed on our discretionary trust portfolio repositioning strategy by selling underperforming securities, reducing our overall exposure to the equity markets, and deploying this capital for better relative value opportunities, particularly in the fixed income market. As a result of this repositioning strategy we have increased our estimated annual income in our discretionary trust portfolio by almost 23% or $2.2 million to $12 million annually.

As stated on previous conference calls we expected our reported Overhead to be significantly higher in the first quarter of this year compared to 2015, primarily due to one-time charges related to the Operation and Strategic Growth Leadership Team changes that occurred throughout 2015 and for the retirement of Bill Heiligbrodt during this quarter. We amended a portion of our agreement with Bill in order to accrue for GAAP purposes all of the charges in this quarter. The amendment in no way changes Carriage's relationship with Bill, it was simply a necessary change for accounting purposes.

Given the one-time nature of these charges, they have been added back in our Non-GAAP reporting for the quarter. Going forward, we expect reported Overhead to trend below 14% of revenue and that one-time charges will be minimal in the future.

Over the past 10 months we have had numerous conversations with investors regarding our Non-GAAP reporting and we have spoken publicly about our intention to have GAAP and Non-GAAP EPS converge over time. As part of this process, beginning with our first quarter release we will only add back in our Non-GAAP reporting special items that are materially outside the normal course of business. We will discontinue reporting Withdrawable Trust Income in our Non-GAAP section as it has become insignificant to our overall results and has been a source of confusion for equity investors. Instead, any cash that is withdrawn from these accounts going forward will be recorded in our Adjusted Free Cash Flow as it has in the past.

Our goal will continue to be to have our transparent Non-GAAP reporting reflect the true earnings power of Carriage's Operating and Consolidation Platform. Given the continued momentum we see in our business and the high performance of all of our Managing Partners and their teams, we are raising our roughly right rolling four quarter earnings per share outlook range by $0.02 to $1.71 - $1.75. This range includes one acquisition and one real estate transaction of currently leased property that will close before the end of the quarter. Both of these transactions are consistent with our commitment to allocate our internally generated capital to grow intrinsic value per share. The real estate purchase is one of our largest operating leases while the acquisition, like Mel talked about, is a fantastic business in one of our identified strategic markets.

Finally, I would like to mention that this is the earliest Carriage has reported our quarterly financial result in our history and I want to take this opportunity to recognize our entire financial reporting and accounting teams for all of their hard work and dedication over these past few months.

And with that, I would like to turn the call over to Mel.

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

I completely agree with that last comment and commendation to our accounting team; they're just a bunch of A players, what else can you say about them? It's awesome to watch them work, be around them, it's exciting. I had somebody tell me one time you could not apply the 4E leadership model to technical people. Well, I never agreed with that and now it's been proven to be untrue. They're all A players, and our company is full of A players just about everywhere you look, so it's a lot of fun to come to work.

With that, I'll open it up for questions.

QUESTION AND ANSWER

Operator

(Operator Instructions) Scott Schneeberger with Oppenheimer.

Greg Charpentier - ***Oppenheimer - Analyst***

This is Greg on for Scott. I was wondering if you could discuss how you think about funeral volumes with respect to your new rolling fourth quarter outlook and what type of normalized funeral volume growth could we expect for first quarter 2017?

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

I don't know how long you've been covering this industry, but you can model out a lot of different statistical things, progression analysis and so on, but it's just unpredictable. Most people are surprised once they start looking at the industry at the volatility of the seasonality.

What really counts is long-term year-over-year same store apple-to-apple comparisons; that's what really counts. We show that on our five year trend report. That doesn't make it any easier for you to model, but just like the tide went out in the first quarter of this year with volumes, the tide will come back in.

If you look at the last five years, our volumes have been essentially flat. And so, we don't try to model volumes on a quarterly basis; we quit doing that in 2003. Ever since 2003, we got rid of budgets and quarterly modeling because quarterly modeling is nothing but a budget. And budgets didn't make the Company any better; what happens is you have to get better at operating and then don't worry about the death rate or the seasonality of the flu season, because that will drive you nuts.

What you want to do is be better than anybody else in the local market so that you get more market share no matter what the death rate is for what reason; that's the idea of Carriage, and it’s there in full color for anybody to see. Go back and read the shareholder letter where I laid it out over the last five years and it will clear up any confusion you might have.

Greg Charpentier - ***Oppenheimer - Analyst***

And one more if you don't mind; could you discuss some current and future cost initiatives that could be meaningful for continued margin expansion?

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

And once again - how do we get such high margins? I have no idea; it’s not because of cost initiatives or pricing initiatives. In fact, we're initiative free; we're budget free and initiative free, because none of those ever made us any better. You have to go back and read the Company & Investment Profile and read my shareholder letter, because it doesn't sound like you read it to really ask good questions on this call.

Operator

(Operator Instructions) Chris McGinnis with Sidoti.

Chris McGinnis - ***Sidoti - Analyst***

I guess can you just maybe elaborate a little bit on the aforementioned acquisition that you plan on making and maybe a little bit of how long have you been working on it and how long its come together and how confident you feel about the position of it?

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

With all of the acquisition activity, we're building relationships, and we've had relationships in this particular market and business for years. Timing wasn't right; if you don't have alignment of motivated interest, you shouldn't do it. The price won't be the reason to do it, there has to be a mutual alignment of interest for what's going to happen over 5 or 10 years. We had no competition, there was no broker, thank goodness, and it's going to be a wonderful business over the next 5 or 10 years and a wonderful market.

Chris McGinnis - ***Sidoti - Analyst***

And maybe just a touch on that; can you maybe just talk a little bit about the competitive landscape in the industry - the consolidation at the moment?

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

Yes. I mean, we're in a lucky spot. If you just keep trying to get better what to do and handle things that you can control, someday you might wake up and the landscape has turned decidedly in your favor.

I said that in the shareholder letter. When the Company was founded in 1991, I've seen so many consolidators come and go; many, many, many private equity, venture capital, none of them around and the bigger companies, they are all gone; it's just us and SCI, really, with the same framework and profile. So, anybody who's got a succession planning problem or issue at some point is going to have to make a choice.

We think there is a stark choice to be made if that choice is, look, I have a succession planning problem and you are the succession planning solution and I care about the business, I'm not out to milk it for the last nickel or dime, because I still want to be around in the face and the community and I don't want the business to decline, I want it to actually prosper.

Well, look, we are an easy company to check out. If you go to our website, there are so many testimonials that Dave DeCarlo and Michael Cumby have put together; I didn't even know they were going to do this. But, I mean, it's so easy to check us out talking to our people, you know have to listen to me. Talk to our people, call them up; they want to talk to you and tell you what they think about our company. Well, that's going on throughout the industry, so over time that leads to reputational and quality differences that make us one choice, and then there are other choices. We think the landscape over the next 5 or 10 years could not be better.

Chris McGinnis - ***Sidoti - Analyst***

And then one last question; understand the kind of issue on the funeral side, but the improvement in the same store sales on the cemetery, can you just dig a little bit behind that improvement on a year-over-year basis?

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

Have you heard the phrase first who, then what?

Chris McGinnis - ***Sidoti - Analyst***

No, I haven't, actually, I don't think so.

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

All right. Well, look on the cover of our annual report, it’s there; it's a high performance concept. It's the high performance concept that drives everything we do. If you want your what to be high and sustainable, let’s say cemetery sales, broadly speaking. You got to get the who right first. We've gotten the who right better across the cemetery portfolio, especially at our bigger cemeteries.

I see several high performance Managing Partners on this call right now at the cemetery that you are asking about. That's how you do it; it's not that complicated, but you got to have talented people running your business, and if you have to tell them what to do, you don't have the right people. Or if you have to come up with top-down initiatives or programs, you've got the wrong people.

Operator

Alex Paris with Barrington Research.

Alex Paris - ***Barrington Research - Analyst***

I joined the call late, so I don't want to be repetitive here, and if the question was asked, please tell me and I'll get it on the transcript or I'll get it on the follow-up call.

I just have a couple of questions. First off; same store revenues in funeral were down 4.5% year-over-year. It was against one of the second strongest quarters in the Company's history now that this quarter is the strongest, and that was a weak flu season compared to a strong flu season. Over the balance of the year, the comps are significantly easier in that respect.

I know this is very short-term now, but do we expect - is my thinking right there in that regard, the comps are easier over the balance of the year in terms of same store sales for funeral services? And the other question, and the reason it's a question is because the same store revenue is constantly updated as acquisitions mature and become part of the same store revenue.

Mel Payne *- Carriage Services Inc. - Chief Executive Officer and Chairman of the Board*

An acquisition doesn't become part of the same store revenue until five years of ownership. We're not like a retail operation. So, you can really see same store, same store, same store, same store, same store; apples-to-apples over a five year timeframe. We did that for a reason, to prove how good we were at operating these businesses or not; I was told not to do that.

I did it, because people who told me not to do it didn't think that we would ever be as good as we became. And so, if you look at the five year, if you read my shareholder letter.

Alex Paris *- Barrington Research - Analyst*

I guess I did.

Mel Payne *- Carriage Services Inc. - Chief Executive Officer and Chairman of the Board*

Which I asked you to do. You will see that in that five years, our same store funeral revenue was up 0.6%, or 0.6% and our same store funeral field EBITDA was up 3% or 4%. So, do you think there were good quarters and bad quarters in the five years?

Alex Paris *- Barrington Research - Analyst*

I do.

Mel Payne *- Carriage Services Inc. - Chief Executive Officer and Chairman of the Board*

Yes. I don't remember which ones they were and didn't care at the time because this is the deal; when you get businesses like we have across the country full of people like we have and leaders that we have, they are trying to get market share not worry about the death rate or the flu season because that's just going to happen when it happens. I wish it was more predictable, too, but I quit worrying about that a long time ago and went to work on getting the people and the leadership and the market share right. That's what counts.

Just like I said earlier, you probably didn't hear this, I view the first quarter like Warren Buffet used liquidity in the market; when the Fed starts doing dollars and making money so easy, it lifts all boats. The tide comes in lifts all boats in the market and lifts all swimmers swimming, but when it goes out, you get to see which boats are leaky, we call that market share, and which boats really are going to sink and not make it, or whoever is swimming naked, is what he says.

Well, this is the kind of quarter this was. And yes, the tide will come back in, the difference is, we've got people running our businesses - I can only imagine what the quarter would have looked like; it would had – same store volumes we had last year, it would have been sinful. So, will the tide rollback in? Absolutely; it has since I've been doing this 25 years.

I don't know how to predict the quantity every quarter, and I made an earlier comment; quarterly budgets, which is what we're talking about don't work very well for this industry. So, I quit worrying about those things in 2003 and it took 12 years to get the company where - whatever the quarterly seasonality, we can maximize the potential of it through operations.

Alex Paris - ***Barrington Research - Analyst***

No, I hear you and I applaud that. I would not be an investor in the stock on a three month by three month basis, it's definitely based on the long-term track record and the long-term outlook of the steady state, the steady growth of funeral services, the death care business generally speaking and then your ability to outperform that industry number. But -

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

The first quarter, I mean, if you look at first quarter, the acquisition portfolio, and this shows the idea behind the acquisition strategy and the acquisition methodology. Our acquisition grew, which we now owned for a while, hid it out of the park in the first quarter; wasn't just cemeteries, they hit it out the park. And so, we're adding businesses that have higher revenue growth profile through demographics, market share opportunities, and pricing power. We do not think aggressive pre-need funeral sales as a good strategy in this industry because you sell away and fix your prices, your future pricing power.

We don't do that, it makes no sense, and that's why the performance in the first quarter made it look like we're not in the same industry is what I heard it looked like for too many others; that was my dream and now it's come true.

Alex Paris - ***Barrington Research - Analyst***

Yes. It was a great first quarter, the best quarter ever against a really tough comp, and I know you don't like to talk on a quarterly basis like that. But the quarters -

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

Yes, it's awesome. I couldn't even believe the numbers when they came, okay? I'm going somebody cooked the books.

Alex Paris - ***Barrington Research - Analyst***

Let's hope not. So then, just moving on, and, Ben, maybe this question was already asked of you. There was $2.8 million in severance in the quarter; what was that talked about? I don't want to be repetitive here.

Ben Brink - ***Carriage Services Inc. - Co-Chief Financial Officer and Treasurer***

The biggest portion was related to Bill Heiligbrodt's retirement agreement and a majority of that was of that $2.8 million, there was some other overflow from the changes we made in the Operations and Strategic Leadership Team last year that hit here in the first quarter; this was always going to be a large quarter for overhead expenses, and we expected to trend down significantly going forward.

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

Alex, on that, I told Ben and Viki, I said: look we've been out now since September to meet with investors, we've learned a lot, and one of the things that really hurt, I forget who it was, some guy I think in Chicago might have been at your conference said, Mel, Warren Buffett, you're a big fan of Warren Buffett. I said absolutely. He said, well, if he were to look at your reporting, your Non-GAAP reporting, he'd be highly critical. Man, you know how to really hurt a guy.

So we've been trying to shrink the gap between Non-GAAP and GAAP and nothing has changed with Bill, but we had to modify the agreement. He is a friend of this company and me personally; he is here down in office he has got a wonderful assistant, he is not going anywhere, if we need his help we will ask him. We just had to modify to wash it out so that the GAAP earnings will now look closer to what we've been showing as Non-GAAP.

Alex Paris - ***Barrington Research - Analyst***

And then I assume that came in on the total variable overhead line, Ben?

Ben Brink - ***Carriage Services Inc. - Co-Chief Financial Officer and Treasurer***

Yes.

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

And, I mean, Ben said it's going to go down less that 14%.

Ben Brink - ***Carriage Services Inc. - Co-Chief Financial Officer and Treasurer***

Yes, 14% overall.

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

Total revenue.

Alex Paris - ***Barrington Research - Analyst***

And then I guess my last question because I'm going to have a little time with you guys tomorrow, is on guidance. What tax rate are you assuming on the rolling four quarter guidance? And then, related to that, the LOI; are we assuming this is a typical sized funeral home just in terms of annual revenue production?

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

Yes. It's a wonderful business, well known business, but it's not a huge business - we hope it will be over the next 5 or 10 years, that's the idea.

Alex Paris - ***Barrington Research - Analyst***

Good. And then -

Viki Blinderman - ***Carriage Services Inc. - Co-Chief Financial Officer and Chief Accounting Officer***

Alex, the affective rate we're still using is around 40%.

Ben Brink - ***Carriage Services Inc. - Co-Chief Financial Officer and Treasurer***

You might have missed the comments also on this lease we're buying out; that's a big deal.

Alex Paris - ***Barrington Research - Analyst***

Go ahead.

Ben Brink - ***Carriage Services Inc. - Co-Chief Financial Officer and Treasurer***

Yes. On the lease purchase, we're thinking it's going to be about $0.5 million in additional EBITDA a year; it was a good lease for us to get out.

Operator

Thank you. And I'm showing no further questions at this time. I'd like to turn the call back to Mr. Payne for closing remarks.

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

I don't have any closing remarks other than to say: we're very excited, the team here, to go to Montreal this week starting on a Thursday. We have three nights, four days with our top performing pinnacle winners and we're going to treat them like kings and queens that they are; high performance all.

We listed 14 in the press release; we promoted them to print, and it's an exciting time for our company and for our people. So expect to see a lot of energy and passion in Montreal over the next few days.

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.