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CSV - Q4 2017 Carriage Services Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 15, 2018 / 3:30PM GMT

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PRESENTATION

Viki King Blinderman - *Carriage Services, Inc. - Principal Financial Officer, CAO, SVP and Secretary*

Good morning, ladies and gentlemen, and welcome to the Carriage Services Year-end 2017 Earnings Conference Call. (Operator Instructions) And please note that this event is being recorded. Myself, Viki Blinderman, Senior Vice President, Principal Financial Officer; Mel Payne, Chairman and Chief Executive Officer; Mark Bruce, Chief Operating Officer; and Ben Brink, Chief Financial Officer, will be on the call.

Today, we'll be discussing the company's results after our year-end 2017, which was released yesterday after the market closed. We have posted the press release, including supplemental financial tables and information, on its Investors page of our website. The audio conference is being recorded, and an archive will be made available on our website later today through February 19. And replay information for the call can be found on the press release distributed yesterday. Today's call will -- again, will begin with formal remarks from management followed by a question-and-answer period.

Please note that during the call, we will make forward-looking statements in accordance with our safe harbor provisions 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 SEC. 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 the morning's call, we will reference certain non-GAAP financial performance measures. Management's opinion regarding the usefulness of such measures together with a 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 SEC.

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

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Thank you, Viki. Our 2017 reported consolidated results did not meet our own high-performance expectations, as all of our key metrics declined versus 2016. Overall revenue increased 4% to $258.1 million, while adjusted net income declined 12.9% to $24.7 million, adjusted diluted EPS declined 14.2% to $1.39, adjusted consolidated EBITDA declined 6.8% to $68.7 million and adjusted consolidated EBITDA margins declined 310 basis points to 26.6%.

The decline in our consolidated results can primarily be attributed to factors we discussed throughout the year: a decline in preneed cemetery property sales at 4 of our largest cemeteries linked to cemetery sales leadership changes made during the first and second quarters, lower Acquisition Funeral Field EBITDA margin due to higher operating expenses at businesses acquired in the latter part of 2016 and increased overhead expenditures and investments in people, particularly in our corporate development and information technology teams.

Higher health care expenses related to a series of large claims and reduced current income earned from our cemetery perpetual care trust also negatively affected our financial and operating results in 2017. While our 2017 consolidated results were disappointing, we experienced a number of positive operating trends in the second half of the year, and we've seen those trends continue in the first part of 2018. These improving operating trends included the following: On a pro forma basis, adjusting for 2 businesses we sold last year, our same-store Funeral segment grew contract volume by 3.2% and revenue by 2.6%. The growth in contract volume was the fastest rate of year-over-year growth, and the increase in revenue was the second-best year-over-year improvement since we introduced our innovative and transparent trend reporting in 2007.

In the fourth quarter, our Acquisition Funeral Home segment Field EBITDA margins were 42.3%, an improvement of 120 basis points from the fourth quarter of 2016 and a 940 basis point improvement versus the third quarter. This was accomplished while we integrated 3 new acquisitions that included 7 new Funeral Home businesses. It's also important to note that businesses we acquired between 2013 and 2015 and have, therefore, been a part of Carriage for over 2 years grew revenue over 4% and grew Field EBITDA by over 8% versus 2016. Also, in the fourth quarter, our Cemetery segment returned to growth, with revenue growing 7% and Field EBITDA increasing 7.8% year-over-year.

Cemetery Field EBITDA margins were 31.4% in the fourth quarter, the highest in the last 6 quarters. Our record GAAP diluted earnings per share of $2.09 benefited from a $17.2 million credit related to the recently passed Tax Cuts and Jobs Act. Tax reform legislation is an important step forward for our country. Specifically to Carriage, it enhances our ability to execute on our 10-year vision to affiliate with the best remaining independent funeral and cemetery businesses. The tax reform legislation also increases the number of value-creation investment opportunities that are available to us. The value created from these opportunities will accrue directly to the Carriage employees, the communities in which we serve and to our shareholders. Going forward we expect our effective tax rate to fall between 26% and 28%. For 2018, we currently expect to be at the high end of that range at approximately 27.5%.

And now I'll turn the call over to Mark for further discussion of our operating results.

Mark R. Bruce - *Carriage Services, Inc. - COO and EVP*

Thank you, Ben. As Ben shared, the consolidated results for the 3 months and 12 months ending December 31, 2017, do not meet our expectations for high performance. However, we continue to be encouraged by the underlying trends throughout our same-store Funeral operations and continued progress in our Cemetery sales and Acquired Funeral portfolios.

So let me provide some color. Same-store Funeral operations. The main focus of our Standards Operating Model is to grow same-store Funeral contract volumes, which are the number of families served in a particular business and which we refer to as market share. It is not market share in the technical sense of a percentage of a particular market. But we have learned that it is an indicator whether a business' contract volumes are growing, stable or in decline. The market share standard is determined by business and is the average of the number of families served in a particular business over the last 3 years. For example, for 2018, it is the average of the number of families served in a particular business in 2017, 2016 and 2015. We place the most emphasis on the market share standard, and it is weighted 30% out of the 100% of possible standards achievement because volume growth positively drives operating leverage and leads to higher growth in Field EBITDA dollars and margin.

We believe that market share performance is based on having the right who people in every role of business, and when well led, produces contract volume and revenue growth and high and sustainable operating margins.

For the 3 months ending December 31, 2017, we increased same-store Funeral Home contract volumes by 1.5% and revenue by 0.3%. For the 12 months ending December 31, 2017, we increased same-store Funeral contract volumes by 1.1% and revenue by 1.5%. From a standards perspective, which is how we look at our businesses, this performance was a result of strong execution of our mission statement, guiding principles and Standards

Operating Model, evidenced by 62% of our same-store Funeral businesses achieving their annual market share standard for 2017 compared to 47% of same-store Funeral businesses achieving our annual market share standard in 2016. And 2016, you will recall, was a year of record performance.

For the 12 months ending December 31, 2017, we did not convert the 1.5% same-store Funeral Home revenue increases into expected EBITDA margins. In the short term, increases to salary and benefits and general liability and other interest expenses had an adverse impact on our same-store Funeral Field EBITDA margins. As you will recall from previous discussion, we made strategic decisions to decluster same-store Funeral businesses in 10 markets. That is, we added a managing partner into a business that may have been part of a group of 2 or more businesses and previously led by a single managing partner. In making these investments, we understood we may miss, in the short term, salary and benefits and EBITDA standards as we work to grow contract volumes and revenues. We believe that the decision to decluster businesses, that is, introduce a managing partner to more businesses, had a significant impact on market share standard performance in 2017. And we expected the EBITDA margin impairment to be short term and trending over time to be consistent with our expectations of high performance in 2018.

Acquired Funeral operations. As we've shared throughout the year, weakness in our Acquired Funeral Home portfolio was highly concentrated in 3 businesses acquired in 2016 and not yet fully integrated under our Being The Best Standards Operating Model. For the 3 months ending December 31, 2017, these businesses began to demonstrate the characteristics of Being The Best businesses and contributed to the 120 basis point improvement in Acquired Funeral Field EBITDA margins of 42.3%. There's still much more work to do for these local leaders to internalize, practice and continuously improve as their performance is now being measured against high-performing peers Being The Best Standards performance. We are encouraged by these improvements and expect continued performance in 2018.

Cemetery sales. For the 3 months ending December 31, 2017, same-store Cemetery revenue improved 6.7%, and same-store Cemetery Field EBITDA improved 7.4%. While there is much more work to do, we're encouraged by recent performance improvements and expect continued performance in 2018. Ben?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Our total return for our discretionary trust portfolio was 13.1% for the year. Throughout the year, we slightly reduced the exposure to high-yield fixed income securities as we saw better relative value opportunities in individual equity securities. These changes -- this change in our asset allocation strategy negatively impacted our Cemetery financial revenue, particularly from a reduction in income earned through our cemetery perpetual care funds. Overall, the $1.1 million decline in financial revenue was also negatively impacted by our decision to not take certain withdrawals at the end of the year due to the strength of the financial markets and the performance of our own portfolio. Total overhead costs increased 1.5% to $36.4 million during the year, and overhead as a percentage of revenue declined 40 basis points to 14.1%. Overhead expenses were higher than our expectations coming into 2017. We've made significant progress this year in improving our overall overhead structure and believe we have a great opportunity to continue to leverage our overhead platform so that more organic revenue growth and acquired revenue accrue directly to our bottom line. We fully expect the long-term trend of a decline in overhead as a percentage of revenue to continue in 2018.

Our year-end pro forma leverage, based on the calculation contained in our credit facility, was 5x, the very top of our previously discussed range for where we feel comfortable in operating the business. Our intention is to have leverage fall closer to mid-4x over the next 18 to 24 months, primarily through improved operating performance. We have the necessary liquidity and financial flexibility to continue to execute on our strategic acquisition model.

We were pleased to announce 3 acquisitions in the fourth quarter, which included 7 Funeral Home businesses and would like to take this opportunity to welcome them to the Carriage family. Heath Carroll and his team at Carroll-Lewellen Funeral & Cremation Services in Longmont, Colorado; Dave Viegut and the team at Viegut Funeral Home in Loveland, Colorado; Beth Dalton and Tim Dalton their teams at Thomas F. Dalton Funeral Homes in Floral Park, New Hyde Park, Williston Park, Levittown and Hicksville, New York. We're excited about our future partnerships with these first-class businesses. We remain confident in the incredible opportunity for an increased pace of industry consolidation over the next 10 years and in our ability to execute at a high level on our strategic acquisition model.

We are increasing our Roughly Right rolling 4-quarter adjusted diluted EPS outlook to $2 to $2.05, a 16% increase from our previous outlook. The increase can be attributed to the recently enacted tax reform legislation and current operating trends. This outlook does not include any acquisitions currently under the letter of intent. We've not closed on the fourth acquisition we had under the letter of intent and announced as part of our rolling 4-quarter outlook in the third quarter and currently do not have a time frame for when or if it will close.

While our 2017 consolidated results were certainly disappointing, there's been a lot of hard work and tough decisions made across our company to ensure we are true to our commitment to make 2018 the best year in Carriage's 27-year history. As evidenced by the operating results of the fourth quarter, we believe that many of the changes we made in 2017 have set us up to have a great 2018. All of us here at Carriage remain excited for the year ahead and look forward to reporting our results throughout the year. Mark?

Mark R. Bruce - *Carriage Services, Inc. - COO and EVP*

Thank you, Ben. Now I'd like to direct my comments to our many managing partners on today's call and talk about 10-year vision, 5-year strategy and 1-year plans. As a company, we think in terms of 10-year visions, 5-year strategies and 1-year plans. Starting in late 2017, the operating support leadership team began working with each managing partner on a 10-year vision, 5-year strategy and 1-year plan for their business, imagining without limit the possibilities of high performance for each business, locally developed, locally led and locally executed, consistent with our mission statement, guiding principles and supported by our 3 operating models: 4E Leadership, Standards Operating and Strategic Acquisitions. These individual visions, strategies and plans will become the road map for each business in defining high performance locally against our high-performing peers' Being The Best Standards performance across the company. It's in keeping with this idea that I'm pleased to announce the theme for this year. Carriage Services 2018: Our Guiding Principles and Shared Being The Best Ten-Year Vision and Execution of Each Business.

Now as is our custom, it's my honor to announce our High Performance Heroes. For 2017 Being The Best Pinnacle of Service Award: Curtis Ottinger, Heritage Funeral Home, Chattanooga, Tennessee; Matt Simpson, Fry Memorial Chapel, Tracy, California; Michael Nicosia, Ouimet Brothers Concord Funeral Chapel, Concord, California; Andy Shemwell, Maddux Fuqua-Hinton Funeral Home, Hopkinsville, Kentucky; Justin Luyben, Evans-Brown Mortuaries & Crematory, Sun City, California; Verdo Werre, McNary-Moore Funeral Service, Colusa, California; Jim Terry, James J. Terry Funeral Home, Downingtown, Pennsylvania; Tim Miller, Fuller Funeral Home-Cremation Services East, Naples, Florida; John Fitzpatrick, Donohue Cecere Funeral Directors, Westbury, New York; Tim Hauck, Harvey-Engelhardt/Fuller Metz, Fort Myers, Florida; David Rogers, Garden of Memories Funeral Home, Metairie, Louisiana; Alan Kerrick, Dakan Funeral Chapel, Caldwell, Idaho; Bill Martinez, Stanfill Funeral Home, Miami, Florida; Wayne Lovelace, Lotz Funeral Home, Vinton, Virginia; Brad Shemwell, Latham Funeral Home, Elkton, Kentucky; Brian Binion, Steen Funeral Homes, Ashland, Kentucky; Steve Mora, Conejo Mountain Funeral Home and Memorial Park, Camarillo, California; Jason Cox, Lane Funeral Home South Crest, Rossville, Georgia; Kim Borselli, Fuller Funeral Home-Cremation Service, Pine Ridge, Naples, Florida; Charlie Egan, Greenwood Funeral Home, New Orleans, Louisiana; Sue Keenan, Byron Keenan Funeral Home & Cremation, Springfield, Massachusetts; James Bass, Emerald Coast McLaughlin Mortuary, Fort Walton Beach, Florida; McLaughlin Twin Cities Funeral Home, Niceville, Florida. Ben?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

The managing partners who achieved the Being The Best 100% of Standards award for the year: Jeff Seaman, Dwayne R. Spence Funeral Home, Canal Winchester, Ohio; Courtney Charvet, North Brevard Funeral Home, Titusville, Florida; David DeRubveis, Cody-White Funeral Service in Milford, Connecticut; Joseph Newkirk, West Contra Costa Group, Richmond, California; and Jeff Hardwick, Bryan & Hardwick Funeral Home, Zanesville, Ohio.

Now for our managing partners who achieved both the Being The Best Pinnacle of Service Award and 100% of Standards award: Ken Summers, P.L. Fry & Son Funeral Home; Manteca, California; Nicholas Welzenbach, Darling and Fisher Funeral Homes, Los Gatos, California; Jeff Moore, Sterling-White Funeral Home, Crosby, Texas; Bob Pollard, Lotz Funeral Home in Salem, Virginia; Patrick Schoen, Jacob Schoen & Son Funeral Home in New Orleans, Louisiana; Scott Griffith, Woodtick/Frigon Funeral Homes, Wolcott, Connecticut; and Scott Sanderford, Everly-Wheatley Funeral Home in Alexandria, Virginia.

We'd also like to take the opportunity to recognize our 3 Good to Great award winners for the year. These individuals and their teams grew their businesses above 2% revenue for a full 5 years. Our Good to Great award recognizes individuals who were able to grow their business and prosper over a long-term time frame. The winners this year: Cyndi Hoots, Schmidt Funeral Home, Katy, Texas; Jim Terry, James J. Terry Funeral Home in

Downingtown, Pennsylvania; and finally, Michael Nicosia, Chapel of San Ramon Valley, Danville, California. Congratulations to all the winners this year.

And with that, I will turn it over to Mel.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Thank you, Ben. Thank you, Mark. Thank you, Viki. It is indeed an honor to lead this company and to be at this place in the evolution of our learning journey, what we call a Good to Great Journey that never ends.

It has been very difficult for me over the last 13 or 14 years to explain the high-performance ideas and concepts that comprise the Carriage culture. But just for an example, I was told years ago, we were wasting way too much time calling out these High Performance Heroes on these calls, that I got important investors out there that want to know number stuff. Well, what we have learned are 2 things: recognition is the highest form of motivation, and because of the Standards Operating Model, we have no budgets, nowhere, no time. So we have learned that if you want to unleash the power in each of these businesses, you have to recognize and reward the best. And over the last 13 years, we've learned how to define the best and recruit the best and reward the best and recognize the best.

It's not hard -- it's not easy to grow a business like they grow. But they do. And all these names that you heard today on this call are for managing partners of a single business. This press release and calling out their name was the first they learned of their winning the award. Their employees now know it, they know it. They're probably celebrating listening to the call. When we get a list of people who called in, it's mostly Carriage people. And they're just calling in from everywhere. This is how you get people to stretch, how you get people to think bigger than just themselves, how to perform at a higher level than they thought was possible. And it is a very exciting thing to witness.

I'll close by simply saying, on January 6, I celebrated my 75th birthday party. It was an unbelievable occasion, a milestone event. We had the top leadership from Carriage from all over the country attend. We had each member of our Standards council. All the people that I acknowledged in my 2016 shareholder letter that were still alive came, and it was a real honor and a humbling experience for me to see what this company has meant to so many people.

The theme of the party was not just to celebrate 75 years of history. The theme of the party was the next chapter. The next chapter you can think of as beginning on January 1, 2018. This will be our most exciting chapter.

It is so exciting. We had a board meeting yesterday. It was the best board meeting we've had in the history of our company. I invited a former owner from Panama City to join our board as an adviser director yesterday. His name is Greg Brudnicki. He is now on his third term as mayor of Panama City. He joined our company in November '97, right close to the peak of the market before the crash. He has a big combination business in Panama City, but he also started a venture in Fort Walton. He had 2 of the Good to Great winners over 5 years that we celebrated last year, and they were 2 of the top winners. And their Good to Great awards were, in one case, closer to $1 million than $0.5 million. In another case, closer to $0.5 million than a couple hundred thousand. These are life-changing awards for these managing partners. And the word spreads, so you attract more of top talent to a company like ours.

It is an awesome thing to witness the transformation in people's lives that you can make by just supporting their winning in their market and their winning teams of employees. It's just incredible to watch. And at the end of the meeting yesterday -- we recruited a managing partner for Greg's business both in Panama City and Fort Walton long ago. And he's still involved, but he wanted to run for mayor's office. Now he gets elected every time he runs. And I ask him to tell the entire board and management team what he thought at the end of yesterday's meeting. He shook his head in complete awe. He said that this is inconceivable what I've heard today. Inconceivable. It couldn't have been imagined or dreamed back when I was on the board.

With that, I invite everyone along for the ride because the inconceivable and the dream will become a reality over the next 5 or 10 years. With that I'd like to open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Alex Paris with Barrington Research.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

A big happy birthday to Mel. It's a milestone. Congratulations. It's been great covering the company over the last few years, and your present is a -- the best quarter of the year, and it looks like you're set up very well for 2018 at this point.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

I'd say that's an understatement.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

Well, I'm just being conservative.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

I understand.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

Moving on, I got a couple of specifics. I guess, I'll start with M&A. Congratulations on the fourth quarter success, closing these 3 acquisitions, these 7 funeral homes. And it was particularly noteworthy the size of these acquisitions that you've made, especially the Thomas F. Dalton, with 5 chapels and 900 calls per year. I'm just wondering about pricing. What has been the trend in pricing acquisitions lately? I would assume you'd pay a little bit more for a bigger acquisition in a strategic market. And then related to that, what effect, if any, will tax reform have on consolidation within the industry and then potentially pricing return on investment as you contemplate future acquisitions?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Yes. Alex, this is Ben. I would say pricing for acquisition activity has been pretty consistent from what we've been talking about previously. We're in that 6.5x to 7.5x EBITDA range. And like you said, the larger the acquisition, the more attractive the market. And our confidence in the future growth of that business will drive where that multiple will be. We have an innovative system where we rank our businesses on 10 criteria. That 10 criteria will be the best indicator we have at future revenue growth. The score of that is a large driver of those multiples. We think tax reform can only help industry consolidation from this standpoint. If you look at the long-term history of our industry, there really hasn't been a lot of consolidation over the last 18 years really since the go, go days of the late '90s. We believe a lot of people are going to be looking more seriously and making a large decision about their business, and tax reform may play a role in it. Now obviously, you lower the tax rate, it does affect the returns we have on these in a positive way. We don't believe it should or will affect what we're going to pay for these businesses as we move forward. We want to remain disciplined. That's core to us. We're not in any position where we have to make acquisitions. We want to make sure we make the right ones at the right time with the right partners for the long term.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

This is Mel, Alex. We got away from what we did in the '90s, where we'd look at a business, we'd come up with a pro forma Field EBITDA, would put a multiple on it and then you kind of went with whatever the trend in multiple was, so you got the deals. And the trend accelerated north and then we didn't get what we paid for in too many cases. So you wise up, and you have to come up with better ideas. The key in making acquisitions is how it will perform over a long period of time in the future. We want to buy businesses, much like Berkshire Hathaway describes, that will grow and have more opportunity to deploy capital in the future, in their markets. By definition, that means you're going to stay away from small markets because you're limited in terms of the population, the opportunity to maneuver within the market, add on other businesses. And so these 10 strategic criteria are not financial criteria. These are things that will help us define based on experience with our own portfolio over 27 years, the likely range of revenue growth in the future based on competitive standing in the market, demographics. The history of volume growth is the best indicator of future volume growth. They're just simple commonsense things with boots on the ground. You cannot figure this out back in an ivory tower in Houston. And so we've gotten better and better at ranking. We now rank these 10 criteria each weighted differently. And that's not to say we won't reduce it in the future if we say, look, these 2 overlap, let's reduce it to 7 or 8, let's increase the weightings. We are continuously learning and innovating and trying something new that will give us a better handle on what this thing will do. If we can define the future revenue growth within a range -- we know what the normalized Field EBITDA is going to be under the Standards Operating Model once integrated and you got a managing partner in place. So it's -- actually, we don't even need a financial statement to figure this out. This blows the mind of financial people. Now I'm a financial person. But that's what we look at. So the multiple is going to be determined by the strategic ranking. We also want to pay a fair price for a good business. That doesn't mean a low price. Because if it's high on the strategic ranking criteria, by definition, it's going to be a higher multiple, higher revenue growth in the future. And if the revenue is growing, the EBITDA margins will be growing faster and compounding and creating value creation for our shareholders. So we know what we're doing.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

Great. I really appreciate that color. That was very helpful. Just a couple of follow-ups. Do you think there is any pent-up demand from individuals awaiting tax reform that could be resolved now that there's more certainty there? And just generally, what is the character of the pipeline? I think the language in the press release is pretty optimistic for consolidation activity in 2018.

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

It's hard to say, Alex, about pent-up demand. It's -- that's a tough one to pinpoint. What I would say is what we've experienced, and the real change over the last 9 to 12 months as Shawn and the rest of the corporate development team are out there developing relationships, identifying attractive targets and markets, is that we have more people leaning in and wanting to know more about the Carriage story, wanting to know more about how we differentiate ourselves within this industry and really asking great questions about what their business can look like into the future under an ownership structure with Carriage. More so in the past, people are turning us away or saying, hey, come back to us in a few years. So that's been encouraging. I think the work that Shawn and his team are doing and what we see and who we're talking to and who we're evaluating, the quality continues to improve and continues to make us excited to say the things we say on the call and in the press release about our future acquisition activity.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

I will say this, Alex, I've been out with the team, I've been out with Shawn and his team, I like being out on the playing field, in the hunt, so to speak. And I do sense that whether it's been a catalyst, the tax reform, or it's just been a very long time since the late '90s, the peak of the last consolidation mania, there hasn't been nearly as much consolidation on the independent owner side as there has been since then of other consolidators, the Alderwoods, the Stewarts and others. So I do think, based on our feedback that Shawn has been giving me, that more people are taking a look and interested in what their options are. The businesses have -- the good ones, I mean, have certainly not gone down in value, and people know what they've got. The key with us is that we look at the motivations of a seller, and we look for alignment. If we don't have alignment, we won't have a good integration, and we won't have a good partnership. And that's what we're looking for is good partnerships of good businesses, where we pay a fair price, not a low price, and both sides win. Over time, word is getting now about Carriage that if you want to think about Carriage and the succession planning solution, you're not selling out, you're joining in with another huge group of elite businesses across the country that are supported but not managed from above and it's decentralized against high-performance standards. So when they learn about this and talk to our other former owners and key people, the lights start to come on and then they begin to look at it differently. And I think Shawn and his team have done a great job so different from anything else prior teams were doing that we're all excited about.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

Great. Just shifting gears. In the press release, the momentum shown in these segments in the fourth quarter has accelerated in 2018. You're referring to the Cemetery that was under pressure, preneed sales at 4 locations, I think, primarily and the Acquisition Funeral Home Field EBITDA. What's the tone of the rest of the business, in general? I'm wondering, we see in the news every night how horrible the cold and flu season is this year across the country. Are we seeing strong and perhaps accelerating momentum across the same stores as well?

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Alex, I promised myself a long time I wouldn't try to bank seasonality even really when it's just kind of crazy. It has been a little crazy on the death rate. Looking at January, it's a little crazy. It mirrors what you hear on the news. And all I would say is, I saw this happen in January of '94 with my first group. And I looked at January's numbers, and I said, oh my God, I'm rich. By the end of the year, I was poor again. So we believe that it will settle out during the year, but the real point is that we see broad high performance in alignment with what Mark said about each company having a 10-year -- each business having a 10-year vision, a 5-year strategy, a 1-year plan. I can tell you that 1-year plan right now is looking pretty good.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

Yes. No, I get it. And cold and flu really just pull forward deaths that would have normally occurred. So if you have a strong first half because of cold and flu, there'd be some normalization, one would assume, in the second half .

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

We're not assuming. This is the beginning of that baby bubble moving through the pipeline that I was told about 27 years ago.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

And we're still waiting for it.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

I just don't want to be part of it.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

Yes. I get it, and I appreciate it. Last question, and then I'll turn it over. You talked about your pro forma leverage at 5x, top of the comfort range. You have dry powder on your balance sheet to make more acquisitions. What could you do to increase that liquidity? And is it possible that we'll see net leverage increase before we see it go down due to acquisitions?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Alex, I would say, on a pro forma basis, as we acquire because we fund the majority of our acquisition activity through internally generated free cash flow, that will be leverage accretive as we move forward. Our goal is to bring it down. And really the biggest contributor to that will be improved EBITDA performance, not only from our existing businesses, but from the acquisitions we've made here recently. What I would say is, we're constantly looking at opportunities around -- it is a broader discussion around our capital structure. We've been pretty open in the past that, in particular, the convertible note that we have outstanding is not the most ideal piece of paper for us within our capital structure. I can tell you we've done a lot of work around different options we have around our capital structure. And any changes around that will really be driven by current market conditions and our overall level of acquisition activity, hence, the need for capital. But leverage, we've heard the concerns from investors loud and clear about leverage. And we do have the intention of bringing it down into the lower -- the mid to lower end of that range.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research and Education & Business Services Analyst*

Yes. I hear that a lot, too, although it is fairly common within this industry to carry high levels of leverage given the predictability of cash flows.

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

No, absolutely. We believe that at this current level that we're at, we are comfortable running the business. It doesn't hinder us from executing on our plans. And the underlying strength of this business and industry certainly support that.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Just a final word on that, Alex. I call myself inside the company the chief mistake maker. I've earned that over and over, over 27 years. I made a huge mistake allowing that convert to be done. It wasn't my idea, but I allowed it to be done. It's my watch, I'm the boss. I regret that more than anyone can possibly know. And so we will deal with that because it has to be dealt with. I think it's holding our stock down. We've got a lot of shorts in the stock. We never had shorts before. And the next thing we do, from a capital structure point of view, we'll be smart, not dumb.

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

And simple.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

And simple.

Operator

And our next question comes from Chris McGinnis with Sidoti & Company.

Christopher Paul McGinnis - *Sidoti & Company, LLC - Special Situations Equity Analyst*

Thanks for the commentary around the quarter and just kind of your experience. It always helps think about the call and what's happening at Carriage. So additionally, congratulations on your recent milestone, Mel. Just a couple of questions. One, just on the improving trends in Cemetery. Is that one market related? Or is that really related or directly tied to the change in the sales or the recent investments you've made around Cemetery?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Yes, Chris, it is entirely related to the changes we've made in Cemetery sales leadership during the course of the year. At Carriage, we believe strongly in first who, then what and getting that right sales leader in place at those businesses, these very large operating businesses within our Cemetery portfolio. Getting that right does take time. We feel like we've gotten those people in place and the teams around them to be successful, and we've certainly seen those results. To your point about making investments, we've -- over the last 3, 4 years, we've made significant investments in differentiated inventory at our best and largest parks within our portfolio. And we continue to see those investments pay off. One of the great things about the Cemetery business is, there's ample opportunity to invest capital in those assets at a very, very attractive rates of return. And we continue to look for those opportunities.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Chris, I know this is not easy to model out, so I feel your frustration, perhaps. But when we got rid of budgets at the end of '03, that was the what. We want to manage to a high and sustainable performance, whether it's in the Funeral business, Cemetery business or whatever. Since then, as the company has evolved, we just get more and more educated on the who being the driver and quit working on the what, pieces of the what. And if you get the who right, and this is hard, and it never ends. The calibration of (inaudible) leadership, cultural fit, risk taking, driving, hungry, market share driven, mission driven, this is not easy to find. But when you find it, you turn it loose, and you don't have to manage it, and you don't have to work on the pieces of the what. Because the high-performance what will follow the right who every time, so much so, in some cases, and this blows our mind, it looks like you made a new acquisition, which you did.

Christopher Paul McGinnis - *Sidoti & Company, LLC - Special Situations Equity Analyst*

Right. I have -- my other questions kind of revolve around that as well. I guess, one, maybe just on the success of the declustering. Are there more regions, I guess, that you could bring that to? And would that be helpful overall? And then secondly, and separately, just around, I guess, talent. Just -- can you maybe just update us where you're at in thinking about the organization? And are there more places to kind of increase the talent level? And it sounded like you're always looking. But maybe just an update around that.

Mark R. Bruce - *Carriage Services, Inc. - COO and EVP*

This is Mark. The answer to that is yes. We have more opportunities where we have businesses currently -- we have more than one operating business managed by a single managing partner. So yes, as an operating support leadership team, we have more opportunities to do that. It is entirely driven around the who. We engage in talent acquisition really every day. And we're certainly -- we have more opportunities to do that. We're in the process of doing that now. So the answer to that is yes.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Chris, Mel. The first group I bought was in -- on July 9 of '93. It was in Chattanooga. And there was a group I bought from SCI. They bought another group called Sentinel Group, so they had to divest. And so they had the cluster of 3, came with a cluster manager. And one business who was in Northwest Chattanooga, so really wasn't in the city. One was within the city, but these were distinct little communities, Red Bank, Soddy Daisy and you had one down in Chattanooga that overlaps into North Georgia. So I went and met all the managers and I said, look, who is this cluster guy? He said, we don't know. He's not from here, and we don't like him, and we're forced to do all this stuff. It's pretty stupid. We have different licensing agreements in Georgia and Tennessee and so that creates all kinds of centralized scheduling problems and this and that. So I said, well, let me go meet that guy and have lunch with him. I went and had lunch with him, and he's the -- he was the dumbest guy I met. So I went back to him and said, hey, I think we're going to leave the cluster manager with the seller. And if we turn you guys loose, what will you do? They said, we'll be free, but we'll still help each other when the other one needs help. Look, this is not complicated. Every place we've declustered, the performance has taken off. We did it then in Roanoke. We did it in Naples, Florida. We did it big time in Springfield, Massachusetts. We've done it here. We've done it there. We've done it here. We wish we could do it everywhere. In the article in Harvard Business Review, March of '03, there is an article. I've referenced it many times, Who Needs Budgets? It talks about this very concept that if you get rid of budgets, you'll find that over time the enterprise will break into smaller, more entrepreneurial units, and you will -- it will lead over time to more organic growth in revenue and profits, which is the opposite of maximizing efficiencies. We have learned that's not the best way for our company to do it, and it leads to performance that otherwise could never be achieved in these businesses.

Christopher Paul McGinnis - *Sidoti & Company, LLC - Special Situations Equity Analyst*

It makes sense. I think, obviously, it looks like it's obviously showing up in your numbers. So I understand. And then maybe just a little bit just on -- I guess, just looking across the organization, you talk about, obviously, this who is very important. Maybe you can just comment on where you're at throughout the company. Then also, how hard is it to bring in new talent at the level that you want in finding them? I don't know you referenced that that's some of the reasons why you announced the names in the beginning to give the recognition. Can you just comment on that a little bit as well?

Mark R. Bruce - *Carriage Services, Inc. - COO and EVP*

It's Mark. Around the who, we attract high performers. So we have high performers that are attracted to us based on our mission statement, our guiding principles and then the 3 operating models that I shared, which are 4E Leadership, Standards Operating and our Strategic Acquisitions. What we find is, while that's attractive to many, not everyone can do that. This is highly entrepreneurial, very competitive. We're very selective. The expectations of those people whose names were called out today is that only the best join Carriage. They want to compete against the very best peer operators in the country. We spend every day engaged on talent discussion, talent acquisition. And it isn't that we have a shortage of candidates that we can find, it is we're very selective in matching the right who talent to the right opportunity that we have within the organization. Because when we get that right, as Mel said, it is -- it's akin to a new acquisition in the same-store business.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Yes. And like I said earlier, we've evolved. So we're constantly evolving the standards. In, let's just say, the Funeral side -- we're 75% Funeral. We have 8 high-performance Funeral standards. And these are not easy to achieve, and it's not like you're supposed to do 100%. That's not success. We want sustained success over years. Because you have to grow the volumes. If you can grow the volumes, that's the leading indicator that you're growing market share. It's proxy. You have to grow the average revenue per contract. So that means your revenue, and your revenue is 45%; 30% for the volumes, 15% for the average revenue. We don't -- if somebody says, the mix change got me on my (inaudible), that's a personal problem. That's not our problem. They either make it or they don't. You've got to go up 2% a year. Now in 2010 -- starting in 2011, I always wondered, do the employees know about these standards? Because the managing partner could earn up to 6% of EBITDA, you got 100%, and we do have some 100%-ers. So there's some big bonuses paid. You're in-the-money if you go over 50%. So it goes from 50% to 100%, you share in the Field EBITDA. The higher the standard achievement, the higher your percentage of the EBITDA. So we cut the employees in on it, starting in '11 up to 2%. So the managing partner and the employees get up to 8% at 85% to 100% of standards. You take the percentages times that, and we have a formula. And then that caused everyone in the company to have a reason, educate every employee about Being The Best standards. And because this is not purely financial, they take great pride in it and even come up with ideas of how to schedule better, how to do better with your cremation families, all the best ideas are mostly hatched in this laboratory within our Field businesses of experimentation, always trying to get better. They don't come from centralized initiatives back at the Pentagon. Those are the dumbest ideas. In 2012, we went ahead and said, look, if somebody can do 70% of these standards over 5 years, that's really unbelievable. So they're creating a lot of value for themselves, their employees and our shareholders. So why don't we do a 5-year value-creation award, half in stock, half in cash. We did that first payout last year. And you just won't believe what this has done for our company, Chris. Because when people see this is real, not easy, but real, and only the best have a shot of doing it, then everybody else wants to do it. And our job is to support them, just like Mark said, 10-year vision, 5-year strategy, 1-year plan. It's all around a vision of growth and success for them and their local winning teams of employees. This is the most incredible thing, and very few people understand it.

Operator

And our next question comes from Scott Macke with GLA. And our next question comes from Andrew Boord with Fenimore.

Andrew F. Boord - *Fenimore Asset Management Trust - FAM Small Cap Fund - Portfolio Manager*

Just a quick question. I'm a newer shareholder, so I'm coming up the learning curve as fast as I can. But if you guys could talk a little bit about the funeral homes that were struggling and the changes that were made, which is obviously kicking in, but if you could tell me a little bit more about what that looks like at the ground floor level, that'd be super. I'd love to learn more.

Mark R. Bruce - *Carriage Services, Inc. - COO and EVP*

It is what Mel was just speaking of. It is -- this is Mark. It is continuously assessing and looking for the right who leader in each and every business and taking opportunities to decluster businesses, put more leaders in more businesses where that absolutely is the right thing to do.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Andrew, you talk about the 3 businesses that run our acquisition portfolio, the...

Andrew F. Boord - *Fenimore Asset Management Trust - FAM Small Cap Fund - Portfolio Manager*

Yes.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Yes. So this is the thing, I mentioned the 10 strategic criteria. Well, these businesses all fit. They have the right characteristics for a long-term sustained performance once fully integrated. Now this is a misperception. Just because you have a strong franchise in a market doesn't mean you're going to be able to operate under these high-performance standards that Carriage has developed and innovated and evolved. And sometimes it's like, wow. So we're looking for a good franchise. And you don't want to mess up the franchise by trying to rush to a finish line to get where you know you will get given the passage of time. It has to be slower. These are sensitive businesses, and you don't want to stress them with too rapid change, especially in the people. And so sometimes it takes a while. Sometimes they're very well run. We've had some just hit the ground like, bang. Seems like they're integrated the day before they joined us and fit right in. Others take a year or 2. And they will happen. I was commenting yesterday on this trip. We've been out together. Some of the businesses that we bought 4, 5 years ago, they increased revenue over 5 years, say, maybe 1.5%, but they didn't make the 2% compounded. Let's just say, they increased revenue $300,000 over 5 years. For Funeral business, that's not bad. We increased EBITDA $600,000. That's $0.02 cents a share. And yet they didn't make the Good to Great. This is what we're looking for. And we have to insert in that pretty big business some new support managing partner, like an assistant, that was big enough to handle that, who had been with us somewhere else and knew the ropes. So it's case-by-case, and you have to be a good observer of what it is and not try to cookie-cutter some solution and mess it up. We did that in the '90s, and we're not in the business of destroying the value at some of these great franchises that join us.

Andrew F. Boord - *Fenimore Asset Management Trust - FAM Small Cap Fund - Portfolio Manager*

That's great. I'm all for doing it the right way even if it takes a little time, but I just wanted to understand a little better.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

None of our people, Andrew -- everybody in our company understands, there is nothing in the company that is short term. They have no clue about any expectations that anybody has anywhere in this world or the universe about a quarter.

Operator

(Operator Instructions) And our next question comes from Scott Macke with GLA.

Scott Macke

I apologize for that. I'm a little worried that was a warning shot from the conference call gods. I fear I'm setting myself up for a reprimand. I want to ask some questions about the guide that maybe seem a little bit short term in nature, but I hope that you understand they're not. The forecast range encouragingly so implies a nice rebound. And I just want to unpack some of the underlying assumptions just to tease out how much of that is a rebound from some of the issues last year and how much of this is emblematic of perhaps what can happen over the next -- the execution of the next 5-year strategy and beyond. And maybe the starting point, if you could just kind of let us know from the acquisitions that you made following the third quarter, how much revenue and EBITDA is implied in this rolling 4-quarter guide?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

That's a little bit of detail that we don't like to give out. What I will say, in general, Scott, okay, so there is -- in pretty much, I guess, in 3 -- 1/3. 1/3 is improved operating performance, right, giving back to what we -- what Carriage is and what our history has been from an operating performance side; 1/3 of it is the improvement in the -- or the additional acquisitions that we've made in the fourth quarter; and 1/3 of it was related to tax reform. So if you want to build that bridge from our 2017 results to our rolling 4-quarter outlook we've put in there, I would think about it in thirds like that. Does that help?

Scott Macke

Yes. That's very helpful. I can work through those numbers from there.

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

And we -- and I will give you a little hint on how to back into this. We have been a little forward with these acquisitions about number of calls and the size of these businesses. I would say on average, they -- our acquisition activity is going to fit what our current portfolio looks like in terms of averages and (inaudible) these businesses.

Scott Macke

So as I think about contract volume per home and EBITDA, underlying EBITDA margins in those homes, those aren't going to deviate significantly from overall company average?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Yes, correct.

Scott Macke

That's very helpful. And then I can unpack what you just said. But maybe thinking, going forward, over a 5-year time horizon, with what happened in Cemetery in the preneed sales, and it seems like there were a big boost to maybe 2015, 2016 and then a hiccup in 2017. How do you think about what that business should be over the next 5 years? I mean, it seems like it's a smaller portion of the business, but at the extremes, it can certainly move the needle.

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Yes. No, you're absolutely right. So the way we -- when we think about long-term forecasting and thinking about our business, our Funeral business, our same-store, that 1% range, the acquired business is higher than that in terms of revenue growth just based on us executing our strategic acquisition model. In Cemetery, historically, until this year, we've grown over the last 5 or 6 years mid-single digits. So 4%, 5% compound annual revenue growth. In our long-term planning, we're a little below that, but above what we are on the Funeral Home side. Obviously, with Cemeteries, you have more levers to pull versus the Funeral business. It's a much more sales-oriented businesses. We have individual sales team at each of our locations that can drive that revenue growth higher. It's a capital-intensive business. We're constantly looking at investing and developing inventories to push that growth rate higher. And what's been -- what I will say and comment about our Cemetery business in 2017, the weakness we experienced really forced us to go and take a deep dive into our entire Cemetery portfolio, look at our long-term planning around development, look at our sales teams, look at our compensation structures to ensure that we weren't missing anything and that this wasn't -- this was not more than just normal course of business type of things that all happened at the same time. What we are encouraged to find is that, overall, things aren't broken. The feedback that we got from our Cemetery sales counselors and leadership was that compensation structures, the support they're giving, the inventory we developed is exactly what they need to be successful. And then we got even more encouraged by the opportunities that we saw. We've brought in new leadership on our regional partner side that has experience around cemeteries, deep -- and knowledge base around cemeteries. And as we go around and take deep dive in our parks, you get excited about the opportunities that we have moving forward. So that's how we think about it.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

(inaudible) add to what Ben said. Mark brought in a new regional partner with a lot of cemetery experience at a high level, broad level and a long history of excelling in that. Because he knew we needed that. And he's been with us 6, 7, 8 months now. And he was in the meeting yesterday at the board, all my team was, and I went around at the end and asked everybody. And we -- he knows he's got a come through on our cemeteries. And he can do that. And he is committed, and he's not worried about it. But when I asked them, what he thought -- I asked everybody what they thought. His response was, here's what I think, I just wish I'd made this career change 5 years ago, as I can't believe the opportunity that we have now. I said, what, hey, wait a minute, that's what everybody says. Let's just make this 5 years. Somebody else is going to join us in 5 years, so I just wish I'd come 5 years ago. So we're counting on this guy big time, Scott. And I have a lot of faith in Mark's judgment about what he can do for us.

Scott Macke

Okay. Great. And maybe I get my hand as I look at the fourth quarter. But I take all that to mean that if I'm thinking about a starting point for the next 5 years, then 2015, 2016, that was a 30%-plus EBITDA margin business. It declined in 2017. But as I think about 2018 and beyond, then that 30%-plus EBITDA number is probably a better starting point.

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

We feel confident in that, yes.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Absolutely.

Scott Macke

That's very helpful. I want to ask a similar question on the Funeral Field EBITDA margin, which, you guys know the numbers better than I, ticked down a little bit. You talked a little bit about some of the Acquired Funeral Home EBITDA margins. If you can give us an idea in 2018 what you have embedded and what that says about how much is a rebound from some of the issues last year. And as we think about the Standards Operating Model, what should we expect in terms of incremental margins in that business?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Yes. So what I would say in terms of same-store Funeral Home EBITDA margin, I think you can take a look at the last 3 or 4 years and even with a little decline this year. And that will remain fairly consistent as we move forward and probably tick up a little higher. The way we look at it is, in our same-store business or our Funeral business, each dollar of organic incremental revenue growth, approximately 60% of that is going to fall down to Field level EBITDA and then that can vary. But it's really about average at 60%. On the Acquisition Funeral Home side, over the past couple of years, we've had higher margins, about 200 basis points margin higher than our same-store portfolio. That's just a reflection of the type of the business we're buying, larger businesses in larger strategic markets that have a higher revenue profile out of a single facility versus the average of our current same-store portfolio. Our expectation is that, that will continue although probably moderate as we acquire. The idea is we acquire at a faster pace. We're adding more businesses in that acquired portfolio at a more consistent pace. So you're going to have margin stay probably around where we've been over the past 18, 24 months. And then as these roll in after 5 years into our same-store portfolio, you start to have a same-store portfolio with higher margins, higher relative growth rates than we have currently today.

Scott Macke

Got it. Makes sense. And then you touched on this with that answer, is as the acquisition activity picks up and we see some of the changes that had on the corporate expense line item in 2017, as I think about 2018 and beyond, how should I think about that overhead expense as a percent of revenue? And what sort of corporate expense growth should I expect in 2018?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Right. I think in terms of expenses, we should be flat to a little down this year overall. I think we're going to do it on a higher revenue base. So you're going to have overheard as a percentage of revenue, which is the metric we really key in on about how efficiently we're managing our overhead, that should continue to trend down. The idea about Carriage is that we are able to have a -- we're able to leverage our corporate overhead support platform and grow that at a much slower pace than our revenue growth going forward. And so that more of that acquired EBITDA or organic EBITDA growth in our same-store business is, more of that will fall to the bottom line as we move forward.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Scott, it's Mel. I just want to add a little bit color. Ben's right. Back when we did the initial trend reporting innovation in '07, we then began to publish this company investment profile and think of the company over 5- and 10-year time frames and how that would look roughly, right, range of outcomes. And as a financial guy historically, it was easy to see that when we broke it down to trend reports, you've got the -- what people control locally with no allocations, we own all the overhead other than G&A at the local business, which isn't a big deal. So we eat all the overhead, which made us all at the home office over time get better, smarter, more productive and better able to support each business with the support services. Even as we upgraded teams, changed leadership, got better systems and blah, blah, blah. So now here we are headed into 2018. And I think a lot of the changes over the last year done by the support team leaders in Houston with their teams have given us a lot of upside on the overhead leverage. So I would think we'll be able to grow faster, because of Shawn and his group, bigger, better businesses and then leverage more of that through the platform. First, we're buying businesses that have real good chance of growing revenues and generating the operating leverage, so they have more Field EBITDA, and then that Field EBITDA falls down through the overhead platform to the consolidated EBITDA. And that's where the value as created in the free cash flow becomes available for capital allocation. So that's what we see over the next 5 or 10 years. Probably what I missed because of my optimistic nature was, I thought too soon we were big enough to really have this leveraging dynamic kick in. I do think we're close. We're very close to getting the critical mass so that this thing really gets to be a value-creation machine. That's what I think.

Scott Macke

Thank you. Really appreciate that context. And just a final one for me. I'm never going to be smart enough to figure out exactly what's going on in the financial segment. But I want to at least ask about what's happened in the last 2 years so I conceptually understand and kind of anticipate what's going forward. The financial income is down in the last 2 years. I know some of that has to do with the longer-term nature of the investment returns flowing through the contracts. But if maybe you can talk a little bit about what happened in the last 2 years in the financial income line and broadly what we'd expect over the next 5 years.

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Yes. So there are a few moving pieces in there. So really the biggest key drivers have been this, and it's really been around the Cemetery financial revenue, particularly in our perpetual care trust funds. As we've continued to manage our portfolio, we've found better relative value opportunities in equities, even with equity markets all-time highs versus the high-yield fixed income market. High-yield spreads are all-time historic lows, and we don't really feel like we're getting paid appropriately for some of the risk that we would take to allocate capital there. So as we've had bonds that have been called or as we made decision to sell them, those proceeds have either been held in cash or invested in equity securities. So our current annual income in that portfolio has fallen a little bit, nothing dramatic, right. So that has declined the cemetery -- the income earned from our cemetery perpetual care funds. We've also -- and historically, in the past, we've had opportunities to take onetime capital gains out and count them as income in a few certain states. Some of that has been -- through regulatory changes has been taken away from us. And also, just given the way the financial markets have been performing and how we feel about our portfolio, we felt that there is better opportunity to leave that capital within our portfolio to grow and appreciate versus taking it out for booking short-term current income in Carriage. So those have really been the drivers of the decline in financial revenue. I think overall what you would see is that, that line can be very consistent. We've built a portfolio that is reoccurring in nature. And we would have every thought that at some point in the future, we're going to have an opportunity to build back our fixed income exposure. We just seem to get those opportunities once every couple years. So...

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

It's Mel. If you go back to when we took over trust funds on October 14, '08, we had an unbelievable run through that period. We had another unbelievable run after the S&P downgraded the U.S. I'm talking about fixed income. So we rotated into fixed income big time during the crisis and then again after August 5th of '11, all the way through the first half of '12, sold a lot of equities, went into fixed income, it -- price is much lower than par, which then went way up again. Good credits, good credits. And then we got another bite at that apple early part of '16, February 11, I think, was when oil prices hit $26. And so we -- we've taken real focused opportunities to reallocate where the opportunity we knew was good, and that gave us a lot of recurring income while the prices on the fixed income went to par. You might remember on the call, I think you asked me or somebody, I think it was you, asked what are you all buying, and we just bought $4 million of Freeport at a discount at, I don't know, what we'd paid for that, Ben.

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

$0.50, $0.55.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

$0.50, $0.55. So we made millions of dollars on that. And then we took the gains. We had recurring income. But now we see equity. And unless there's another fixed income mess-up, we're now going back to a bigger allocation to equity, especially as we exit some of the TARP warrant portfolio that matures, let's say, at PNC in October of this year, Wells Fargo in October of this year. We'll still keep the AIG and the Zion. We've got huge portfolio of those warrants because they go out to 2021. And those have been big, huge winners for us, and they were actually intended to be a hedge. But they've been huge profit producers. So we'll have to take some gains, and we'll have cash to allocate where we deem it the best relative value.

Scott Macke

No, you're right, that was me who asked about the investment portfolio a few conference calls back, and I've learned a lesson from that. I'm asking for investment tips, I'm going to do it off-line from now on. Could you refresh my memory. I just want to make sure I understand how it works. So the interest income on the cemetery trust portfolio is immediately recognized into income. Is that correct?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

Yes. So here's the difference, right. So on cemetery perpetual care, we earn income off the investments. In the current period, count it as current income in our financial statements. And it's used to offset the care and maintenance expenses in the Cemetery. These are regulatory requirements. It's typically 10% of every preneed property sale that we make at our cemeteries. This is, obviously, different versus the preneed Funeral and Cemetery trusts, where it's all deferred revenue. We don't recognize any of it until the contract is delivered, somebody has passed away and we deliver on the service and merchandise. So as you can see, there's a bit of a disconnect. Over the last 2 years, our total performance and total return in the portfolio has been 35%. And our financial revenue, you see, has declined over those 2 years. That 35%, those gains and those price appreciations show up in future years as you recognize -- as you take in realized gains, allocate that down to the contract level and those contracts begin to mature. So that's a bit of a timing disconnect that you'll see there.

Scott Macke

Got it. And then last one, I promise. So if I wrap all that up and I think about 2018 and beyond, did I hear you say that maybe a little more of the portfolio tilted to fixed income and, therefore, I might expect a little more interest income to directly flow through due to the maintenance requirements? And is that impacted by some of the TARPs rolling off?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

I think you just combined a bunch of things you said into one thing. But what I would say is...

Scott Macke

Well, I told, yes, I was only going to ask one more question, so I had to kind of cram them all together.

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, SVP and Treasurer*

What I would say is because we've allocated less to high-yield income in our portfolio, we should see earnings and income from those cemetery perpetual care trusts level off here, we feel, this year. And so when we look at financial revenue for the year, it's up slightly from where we were this past year.

Operator

And I'm not showing any further questions at this time. I would now like to turn the call back over to Mel Payne for any further remarks.

Melvin C. Payne - *Carriage Services, Inc. - Founder, CEO & Executive Chairman*

Thank you very much. We really appreciate all the good questions today. Sounds like somebody is as excited about what we're doing here as we are. So we appreciate that and are honored by that. And we look forward to reporting our progress as we go through the year. Stay tuned.

Operator

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