CARRIAGE SERVICES, INC.

Moderator: Chris Jones
May 6, 2015
10:30 a.m. ET

Operator: This is conference #33629228.

Good day, ladies and gentlemen, and welcome to the Carriage Services First Quarter 2015 Earnings Webcast. At this time, all participants are in listen-only mode.

Later, we will conduct a question and answer session, and instructions will follow at that time.

If anyone should require operator assistance, please press star then zero on your touchtone telephone. As a reminder, this conference call is being recorded.

I will now turn the conference over to Chris Jones, representing Carriage Services. Please go ahead, sir.

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

Today, we will be discussing the company's 2015 first quarter results, which were released yesterday after the market closed.

Carriage Services has posted the press release, including supplemental financial tables and information, on its Web site, at CarriageServices.com.

This audio conference is being recorded and an archive will be made available on Carriage's Web site. Additionally, later today a telephone replay of this phone call will be made available and active through May 10.

Replay information for the call can be found in the press release, which was distributed yesterday.

On the call today from Management are Mel Payne, Bill Heiligbrodt, and David DeCarlo.

Today's call will begin with formal remarks from Management, followed by a question and answer period.

Please note that during the call, Management will make forward-looking statements in accordance with the Safe Harbor Provision of the Private Securities Litigation Reform Act of 1995.

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

Forward-looking statements, assumptions, or factors stated or referred to on this call are based on information available to Carriage Services as of today.

Carriage Services expressly disclaims any duty to provide updates to these forward-looking statements, assumptions, or other factors after the date of this call to reflect the occurrence of events, circumstances, or changes in expectations.

In addition, during the course of this morning's call, Management will reference certain non-gap financial performance measures.

Management's opinion regarding the usefulness of such measures, together with the reconciliation of such measures to the most directly comparable gap 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 to Mel Payne, Chairman and Chief Executive Officer.

Mel Payne: Thank you, Chris. After co-founding Carriage in '91, I wrote down five guiding principles that would guide the growth and development of our company. The second one was "work hard, have fun, and share the success."

I later had to take the "have fun" out, because our people started hanging these guiding principles in our funeral homes and cemeteries, and I didn't think that was a good idea for grieving families, but I will tell you, right now, I should have the title of Chief Fun Officer.

Talking about this quarter and our people is a lot of fun. It was one quarter that I will never forget. We've had good ones before, we've had some really good ones before, but this one was good-er than any of them.

And with that, I'd like to turn it over to Bill to give you some color on the quarter.

Bill Heiligbrodt: Thank you, Mel, and thank all of you for joining us on the call today.

We are pleased to report a solid start for 2015 in this first quarter. Carriage achieved outstanding first quarter adjusted diluted earnings per share of 43 cents, an increase of almost 36 percent over 2014.

Likewise, our adjusted free cash flow followed our earnings, and increased over four times from $2.3 million in 2014 to $10.8 million in 2015.

Looking behind these numbers, let's look first at revenue. Total revenue increased just under 14 percent in a quarter. All segments of our business reported strong revenue growth.

Total funeral operating revenue increased 14.7 percent with same-store funeral revenue up 6.4 percent. Cemetery operating revenue increased 13.5 percent. Financial revenue followed with a good four percent increase.

We have long said that if Carriage produces high, single-digit revenue growth, or higher, we will produce solid earnings per share growth, and that, in summary, again, is the case in the first quarter.

Thirteen point seven percent growth in revenue, 35.5 percent growth in adjusted, diluted earnings per share. Second, even better, were our operating results with total field EBITDA up 20.7 for the quarter at a margin of 43 and a half percent.

Comprising these numbers, both funeral and cemetery field EBITDA growth was well in excess of the revenue growth. And field margins of 41 percent for funeral and almost 35 percent for cemetery.

Third point. With our previously discussed performance increases, we continue to control our expenses.

Total overhead for the quarter was down $1.6 million at $8.6 million, almost a 16 percent decrease and as a percentage of revenue is now at 13 and a half percent.

Summarizing quality results such as these we are reporting to you today are not easy to accomplish, and represent the combined effort of all the employees of Carriage.

For you, the shareholders of our company, you can see the high performance culture and our team approach, working in collaboration, using our operating models to produce real results.

We're off to a very good start in 2015, and we look forward to reporting to you as we move throughout this year.

Mel?

Mel Payne: Thank you, Bill. After we finalized the maker board in Senior Management Reorganization on November 1 of 2011, we then launched what we have called a Five Year Carriage Good to Great Journey.

Starting in 2012 with a theme "Carriage Services 2012, A New Beginning," we then challenged all of our field and home office leaders, and employees to totally seize the moment with high and sustainable operating and financial performance over the five year period, we explained to each of our people that the market value of Carriage, i.e. our stock price, would follow their sustained high performance over this five year period.

Complemented by acquisitions of the best remaining independents and the best strategic markets in the country, we also explained how each business and each employee in each business and each employee in each home office supports department was important to the success of our Good to Great Journey.

As it only took $314,000 of incremental field EBIDTA to equal one cent per Carriage share, now that we have finished the first quarter of the fourth year of our Five Year Good to Great Journey, I am extraordinarily proud and genuinely humbled to report that all of our leaders and employees, across the company, have responded to the challenge at the end of 2011 with high and sustainable performance that has led to our stock price rising from $5.60 per share at 12/31/11 to over $24 as we now speak.

I want to emphasize the major components of earning power growth over the last three and a quarter years have been broad and continuing throughout the three and a quarter years. Not just this most recently, unbelievable first quarter.

We publish a five year trend report that will be updated after this quarter, in what we call our Company and Investment Profile. That will be included on our Web site.

I encourage each one of you, if you're a long-term shareholder in Carriage, to go there and to get this document, because it shows the same per funeral, the margins, the acquisition funeral, the same-store cemetery, the acquisition cemetery, the financial side, and the overhead and the capital structure items below.

So we have grown the company over this three and a quarter year by 28 percent on total revenue. But we've more than doubled the adjusted net income, and our adjusted, diluted EPS has gone from 64 cents in the base year of '11 prior to the Good to Great Journey beginning in '12.

Sixty-four cents to the most recent four rolling quarters, just finished, from $1.45. That's an amazing improvement over time that we expect to continue over the next year and three quarters.

And after we finish this five year thing at the end of ('16), we'll have another one start. So that the Journey of Good to Great never ends, and we never get there.

It's a good time to not only have a lot of fun if you're in the company, so, a lot of satisfaction to be a shareholder and the COs in the company, and those of you out there, who believed in what we were doing.

With that, I'd like to turn it over to questions.

Operators: Ladies and gentlemen on the phone lines, if you would like to ask a question at this time, please press star followed by the number one key on your touchtone telephone.

If your question has been answered, or you wish to remove yourself from the queue, please press the pound key.

And our first question comes from James Fonda of Sidoti and Company. Your line is now open.

James Fonda: Hey guys, how are you?

Male: Great.

James Fonda: I guess, could you just talk a little bit about the gross margin improvement, and I guess, if you think that expansion is sustainable, going forward?

Male: I don't look at the FCC format, so I can't even comment on that. I look at our trading format.

Bill Heiligbrodt: In general, the answer to the question is, James, that once our revenues go up, we get a leveraging effect...

James Fonda: OK.

Bill Heiligbrodt: I'm going to be talking to that in mind in my comments, so you would expect that our margins are going to go up and our revenues expand. So, I think that's really the answer to the question. It's better, reflected, as Mel said, if you kind of look through the trend report.

For example, you know, like I reported that funeral operating revenue was up 14.7 percent...

James Fonda: Right.

Bill Heiligbrodt: But then when you look at funeral EBITDA, it was up 23 percent. So we get a tremendous leveraging off of that. Also, for the company, as a whole, does.

Again, I'll emphasize that, like we were 13.7 growth in revenue, and 35.5 percent growth in adjusted, diluted earnings per share. The combination of that, and other expense control in operating your businesses create good margins when you run your business correctly.

James Fonda: Right, right. OK.

Mel Payne: Let me comment. It is James? OK. So, you're talking about the SEC reporting format. I don't follow that. We went away from that. I personally don't think that's the thing to be looking at. That's why we created the kind of transparent reporting in our trend reports. That's what we look at, that's what I look at.

James Fonda: Right.

Mel Payne: But, it does translate into a gross margin. Now, this is a seasonable business.

James Fonda: Right.

Mel Payne: Per, of the year. It doesn't mean every quarter will be this good.

James Fonda: Right.

Mel Payne: Either on the field margin level, but I will point out, Bill did mention this. But for the first time in history, the acquisition portfolio, which is businesses we've owned in January 1 of '11.

James Fonda: Right.

Mel Payne: Had a higher field EBITDA margin then our same-store portfolio.

James Fonda: OK.

Mel Payne: What that says is, over time, we're buying bigger businesses in bigger markets.

James Fonda: Right.

Mel Payne: And those will, by definition, have more margin to them, and more leverage of the revenue that you get through the business.

James Fonda: Right, OK.

Mel Payne: For the next five years, you're going to see more of that. So, that translates into a higher gross margin on the funeral side. On the cemetery side, I mean, we've been getting better for four years.

James Fonda: Right.

Mel Payne: We continue to get better at premium property sales, and that translates into higher margins.

James Fonda: Right.

Mel Payne: So, but the good news is that we're keeping our cost down at the overhead level, although we've gotten better at every support department.

James Fonda: Right, OK. Thanks, guys.

Mel Payne: You bet.

Operator: Thank you, and as a reminder, ladies and gentlemen. To ask a question at this time, please press star followed by the number one key.

And our next question comes from Joe Janssen of Barrington Research. Your line is now open.

Joe Janssen: Good morning, Mel. Good morning, Bill.

Bill Heiligbrodt: Yes, Joe.

Mel Payne: Hi Joe.

Joe Janssen: Just, on the rolling four quarter guidance, the adjusted EPS of $1.55 to $1.59, excuse me, (all of), not guidance. I'm just curious. At this point, given the operational efficiencies that you're getting out of the business with the new properties that are coming online, as well as some of the recently acquired businesses, is there any embedded assumption in there for additional acquisitions through the end of the year?

Mel Payne: Yes, there is.

Joe Janssen: And then, OK.

Mel Payne: For sure.

Joe Janssen: I guess that leads me to the next question. Is there, you know, in your prepared remarks, you didn't talk much about this in terms of the pipeline and the acquisition, you know, your general comments are, it's usually robust and solid and the (pipeline's full).

Are you, you know, anything near maybe, in the finish line, and I know a lot can change between now and then, but, maybe any terms of announcements on the acquisition front, maybe in the next three to six months?

Mel Payne: Well, this is Mel. I've been out there. I just got back from hunting big deer and maybe an elephant or tow. That's what we call "big business." Dave

DeCarlo and I are involved in hunting elephants and big deer, and Dave's finished his team, which is an awesome team and they're doing awesome work.

They're focused on the right areas of the country that would be -- I can just give you a few examples. Texas, Carolinas, in and around New York City, down through there. Other places, Pittsburgh, other major markets, and I've never felt better about the quality of the activity.

I've never felt better about, over the next few years, what that will mean to the company, but by definition, when you start romancing the best of the remaining independents in the country, it takes a while to fall in love, and then to engage, and then to have a, you know, a happy marriage.

It's not the kind of thing you can easily plan by quarter. I know that creates challenges for our analysts, I feel your pain, but I am 100 percent confident about where we're heading with our acquisitions. Dave's here and he can comment on his own.

Dave DeCarlo: Yeah, I feel the same way. I am very comfortable with the pipeline and the relationships we're developing especially in these vacant markets.

Mel Payne: I'm spending more and more of my time there because, look, (fix) the operations, how am I going to help there? I'll just mess it up.

Joe Janssen: I'm just curious. I mean, your average transaction, in terms of sales, has been between $2 to three million. You use the term elephant. I'm just curious, you know, to maybe quantify what an elephant would look like in terms of sales.

Mel Payne: It's a multiple of that. Many.

(Alex): Hi guys, it's (Alex). I'm standing here over Joe's shoulder. I just have a question or two, also about the rolling four quarter outlook.

You know, lot of commentary in the press release about what you're doing on the operations side, which is great, you're improving the profitability within cemetery, improving the profitability within funeral homes, you're greenfielding funeral homes, and you're looking to add cemeteries where we already have strong funeral home operations.

So, all those things add together to improve internal growth above what the industry grows. And we all know the industry is a slow growth industry. We also know that, embedded in your guidance, is some assumption for acquisitions not yet announced.

I'm just wondering, with the outperformance of the organic operation, does that sort of, by, you know, because you didn't change your guidance. Does that sort of, by definition, then, say that you have a lower assumption from the number of acquisitions, on the number of acquisitions within that rolling four quarters?

Or the dollars that, the sales dollars that you bring in through acquisitions?

Mel Payne: No, it does not mean that.

(Alex): OK.

Mel Payne: The thing, (Alex), is this. In going back and looking at the company from January 1 of '12, and I have all these numbers, I just don't have time to go over them on a call, well, we looked hard at this.

And we've grown the earning power of the company about half, about half, from internal. Businesses, both funeral homes and cemeteries, and the financial side.

We've grown revenue $10 million over this three and a quarter year period, and we've grown the EBIDTA by $10 million. One for one. That's a lot of EPS, over 30 cents a share by mid-term.

If you look at the acquisition side, it's about the same. So, it's about a 50/50 contribution, roughly, over that period of time. We are 100 percent grow at 8 percent a year on revenue, including acquisitions.

But to quantify it on a quarterly basis, is, in our view, I don't know how to help you with that. But it's going to be there. It's going to be there. My goal, today's goal, is that that should be on the low side. But why go promise it on the front end? Why not just go do it?

(Alex): Got you. So, and I don't know that, and you're right. It is a challenge to model quarters in this business, but...

Mel Payne: It's a good (fulfillment strategy) (Alex) and you start looking at deals and it makes you think differently, and I don't think it's the wise thing to do.

(Alex): No, I hear you. My point was simply, not that, you know, there's thousands of targets out there for you, you know, not that you're going to take it down over the long term. I'm just saying, I used to always assume that you had to make six to eight acquisitions a year.

Mel Payne: That's not true.

(Alex): So, my assumption's wrong.

Mel Payne: Yep, it's wrong. You might make one a year that's even better than the eight.

(Alex): There's no doubt about it. That reduces the risk for the investor, and are less reliant on acquisitions because the timing and magnitude is difficult to predict.

Mel Payne: Let me mention a thing here. I am a big student of Warren Buffett. Huge. And I have learned that patience is a virtue. And when you are patient and you're working on identifying the very best remaining businesses in America, and they tend to be bigger, and bigger markets.

When you get one of those, it allows you not only to have huge earning power from what you bought, but to deploy a demo capital in that business to grow it over time.

I mention that in this press release for a reason. That is what we want to do with this company, is have the allocation of our capital go to businesses that we can grow at a more rapid pace than our existing portfolio of businesses, most of which was acquired in the '90s.

That is not thousands of candidates. It might be a hundred candidates. And those hundred candidates are really good ones. We know who they are. We're talking to them as we speak. There will be others that are what I call bread and butter that make up the six to eight.

But it's going to be a combination over time, and in my view, it will be more than what you could think, or more than what we have said we will do. So, patience, (a year) is a huge asset.

Male: No, I hear you. Once again, I think this is a productive conversation because we do have a revision in the acquisition methodology. Your words in the press release. And I think it's great, you know, you've always gone after the best of the best, but it sounds like you're even going best-er.

Mel Payne: No, I'm sorry. We haven't explained this. The methodology has been changed, but we don't waste time on deals that don't qualify and should not ever even get to the stage of financial analysis and return on invested capital. We kick those out early and don't waste our valuable time on them.

So the methodology of the selection, the ones that make it through, has not changed. But there's a lot stuff you get (from year to year) is junk.

(Alex): Good, well that's very helpful. That answers my question. Thank you very much.

Mel Payne: You bet.

(Alex): And good luck.

Mel Payne: Thank you.

Operator: Thank you. And our next question comes from Nicolas Jansen of Raymond James. Your line is now open.

Nicholas Jansen: Hey guys. Two questions from me. First, regarding the convertible note instrument. I don't believe your share count assumption for EPS guidance reflects the potential dilution there, and what the stock word is today, looks like we might starting to get into that phase of where there could be dilution.

And considering you're having pretty strong free cash flow, and maybe the cadence of (NNA) is going to be more selective. Is there anything that you can do to maybe minimize the level of dilution that could be coming if the stock continues to rise? Thanks.

Bill Heiligbrodt: Yes, Nick, obviously we're looking at that. We have two forms of dilution and they're about even. One is from the convert, the other is from the options that we issue to obtain this as our result from this performance to our employees. It's about even.

So, I think it was a little over 600,000 in this quarter, and it split, pretty much even, so we'll be looking at that. Obviously, the way the convert works, this convert, obviously the only dilution we have is after we reach, and go into the premium phase, of that security.

So, it will only go up if the stock price goes up. The other, we're looking at this point, and I asked and have talked to Mel personally about this within the last week, so yes. The answer.

Mel Payne: Yeah, we're looking at that seriously. We don't want secure accounts to go up.

Nicholas Jansen: OK. Great. That's helpful.

And then, secondly, regarding one of your major areas of focus for 2015, on cemetery, pre-made property sales, historically, you haven't really necessarily talked about pre-need as a large part of your strategy, and maybe just want to get a little bit more color on, kind of, your views on property sales and then kind of where we are today, and where they could be, you know, two to three years from now.

Thanks.

Bill Heiligbrodt: Right, well, I think, number one, in cemetery, that's part of this capital allocation that Mel's been talking about. I really believe that what we've done, and what we're going to be doing over the next few years is making sure that we have enough property, and the right property, to sell.

So, we're reinvesting back in our cemeteries to get in that particular basis. And we're also looking at, you know, how this, you know, and how this revenue -- how you would set it up as far as -- so the resulting sales do benefit the company the most.

So, when you look at a cemetery company, and I look at the first quarter, and having been in this business, I guess since the inception of this business, you know, in this first quarter, our cemeteries, as a whole, did 36 and a half percent margin. I mean, that's almost phenomenal.

That's really unreal, and when we look at same store, I'm just going to put this out, actually our same store EBIDAT growth exceeded our same store revenue growth. And that's because we were able to have better products to sell in our good cemeteries.

And I think that's something that we haven't done before, simply because we were in -- we were a different sized company in a different financial phase than we are today.

So, I think that cemetery, and I will say this, our people are getting very good at running cemeteries. And I'm proud to be here working with them in that regard, so I think you're going to see some continuation in that.

I don't know whether we can hold the margins exactly where they are today, but I promise you we'll be a good performer in cemetery.

Nicholas Jansen: Thanks for the call, guys. Nice job.

Bill Heiligbrodt: Thank you.

Operator: Thank you. And I'm showing no further questions at this time. Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may now disconnect.

Mel Payne: Wait a minute, that's not true.

Operator: Yes sir, everybody's connected.

Mel Payne: What?

Bill Heiligbrodt: They're connected?

David DeCarlo: Stay connected, please.

Mel Payne: Hello?

Operator: Yes. Everybody is connected.

Mel Payne: Look, we never end the call. If I'm asked, every year, when we do self-appraisals, with all our leaders and all across the company, what one thing do they want from me?

They want me to keep calling out the high performance heroes on our conference calls because they've all anticipated whether they've made it or not.

We have learned recognition is the greatest human motivator of all and I am very proud to announce our first quarter performance heroes for 2015.

In the East Region, Jason Higginbotham, Lakeland Funeral Home, Lakeland Florida.

Curtis Ottinger, Heritage Funeral Home and Crematory, Chattanooga, Tennessee.

Chris Chetsas, Cautaudella Funeral Home, Methuen, Massachusetts.

Deanna Kelly, North Brevard, Titusville, Florida.

Patrick Schoen, Jacob Schoen and Sons, New Orleans, Louisiana. That's a new business we acquired from CSI.

Bill Martinez, Stanfill Funeral Home, Miami, Florida.

In the Central Region.

Jeff Hardwick, Bryan & Hardwick Funeral Home, Zanesville, Ohio.

Andy Shemwell, Maddux-Fuqua Funeral Home, Hopkinsville, Kentucky.

Mark Ratliff, Carman & Robinson Funeral Home, Flatwoods, Kentucky.

Kyle Incardona, Hillier Funeral Home, Bryan, Texas. He opens a fabulous new place two days form now. Or, well, today.

Mark Cooper, Roseville Cemetery, Corpus Christi, Texas.

In the West.

Nathan Stippler, Bunker's Mortuary, Las Vegas, Nevada.

Matthew Simpson, Fry Memorial Chapel, Tracy, California.

Scott Dahl, Hennessey Funeral Home, Spokane, Washington.

Steven Mora, Conejo Mountain Funeral Memorial Park, Camarillo, California.

Nicholas Welzenbach, Darling & Fischer Funeral Homes, San Jose, California.

Terry Shotkoski, Cloverdale Funeral Home, Boise, Idaho.

Alan Kerrick, Dakan Home Chapel, Caldwell, Idaho.

And Valerie Hotchkiss-Silva, who was also a high performance hero we did not call out in the fourth quarter but also repeated in the first quarter. Los Gatos Memorial Park, San Jose, California.

Thank you all for listening, and we look forward to reporting in our second quarter.

Thank you.

END