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Q1 2019 Carriage Services Inc Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Carriage Services First Quarter 2019 Earnings Webcast. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to hand over the call to your host, Ms. Viki Blinderman, Senior Vice President.

Viki King Blinderman ***Carriage Services, Inc. - Principal Financial Officer, CAO, Senior VP & Secretary***

Thank you, and good morning, everyone. Today, we will be discussing the company's first quarter results for 2019. Our related earnings release was made public yesterday after the market closed. Carriage Services has posted the press release, including supplemental financial tables and information on the Investors page of our website.

This audio conference is being recorded, and an archive will be made available on our website later today through May 7. Replay information for the call can be found in the press release distributed yesterday.

On the call today for management besides myself is Mel Payne, Chairman and Chief Executive Officer; and Ben Brink, Chief Financial Officer. Today's call will begin with formal remarks from management, followed by a question-and-answer period.

Please note that during the call, we'll be making forward-looking statements in accordance with safe harbor provisions 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 report filed on Form 10-K and other filings with the Securities and Exchange Commission. Forward-looking statements, assumptions or factors stated or referred to on this conference call are based on 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. Furthermore, during the course of this 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, Senior VP & Treasurer***

Thank you, Viki. Overall, we are pleased with our financial and operational results in the first quarter, and with the progress we have made during the first 4 months of our Carriage Services 2019: Back To The Future - A New Beginning - Part II. As expected, we experienced the decline in funeral volumes versus the first quarter of last year due to an unusually severe flu season during the early part of 2018. The decline in funeral volumes and the $2.6 million increase in interest expense from our balance sheet recapitalization process last May, were the primary drivers of the $0.21 year-over-year decline in our diluted earnings per share.

Nonetheless, we saw significant evidence during the first quarter in our operating performance that our managing partners and their high-performance teams have responded to the evolutionary changes we made to our Standards Operating Model that were announced in the fourth quarter of last year.

Over the first 4 months of the year, we've experienced improved morale, collaboration and operational discipline across all of Carriage. We have improved the sharing of unique and creative service ideas throughout our businesses and improved the support resources in specific areas that were identified in feedback from our managing partners last year, and we still have plenty more to do.

In businesses, our specific markets were we continue to face challenges, our operating teams have been proactive and diligent in making the necessary changes to turn those challenges into opportunities. Needless to say, the rapid rate of strategic change here at Carriage has and will persist as we work to take advantage of numerous short-term and long-term opportunities we have across our entire portfolio.

Taken together, we remain confident that our operational and financial results will improve both comparatively to last year and relative to our high-performance expectations throughout the remainder of the year.

Now a review of our financial results. For the first quarter, revenue declined 5.9% to $69.1 million, primarily due to lower same-store funeral home revenue related to the decrease in call volume and a loss of revenue from a Cemetery management contract that ended in the first quarter of last year.

Adjusted consolidated EBITDA declined $1.6 million or 7.1% to $20.9 (sic) [20.8] million, and adjusted consolidated EBITDA margin declined 40 basis points to 30.2%. Our adjusted diluted earnings per share for the first quarter was $0.38, a decline of $0.21 from the first quarter of 2018, primarily driven by lower funeral call volumes and higher interest expense.

In our Funeral Home segment, same-store revenue declined $3.6 million to $45.5 million, same-store field EBITDA declined $2.3 million to $17.9 million, and field EBITDA margin contracted a 190 basis points to 39.5%. The entire decline in field EBITDA margin in our same-store Funeral Home segment was due to lower funeral call volumes and the associated negative operating leverage. We have lower operating expenses in all significant controllable expense categories, which is a positive indicator for improved margin performance as we move through the year.

Margins in our Acquisition Funeral Home portfolio improved 40 basis points to 38.4% as many of the previous issues around integration have been addressed over the past 2 quarters. We are pleased with the progress the business has acquired over the past 2 years have made, and remain excited for their long-term potential.

Cemetery revenue was flat at $11.3 million and Cemetery field EBITDA declined $200,000 to $3.6 million. While not fully evident in first quarter numbers, we've done a lot of heavy lifting throughout our Cemetery portfolio around people, inventory, and sales structure that we believe has generated positive momentum in our sales organization that we can carry the rest of the year and beyond. To all of our sales -- Cemetery sales leaders, counselors and support staff, keep up the good work.

Overhead expenses declined 11.2% or $1 million to $7.8 million, which is in line with our expectation of a decrease of $4 million in overhead expenses in 2019 compared to last year. Noncash stock compensation also declined in line with our expectations due to the cancellation of previously issued performance awards and a decrease in expense related to our recently approved long-term incentive award. Adjusted free cash flow declined $3.8 million due to declines in previously discussed operating results and some small working capital variances that we anticipate will normalize over the rest of the year.

As a reminder, free cash flow will benefit from Carriage paying no federal cash income taxes in 2019. We still expect capital expenditures to be between $17 million and $19 million this year, with maintenance CapEx representing $10 million of that number. Also our covenant compliance debt-to-EBITDA leverage ratio increased slightly to 5.2x.

To summarize, we feel good about the progress we've made in the short amount of time, and remain confident that our results will improve throughout the rest of the year as we begin to show the true earnings power of Carriage. We are, therefore, reiterating our rolling 4-quarter adjusted diluting earnings per share outlook to $1.34 and $1.44.

I would now like to introduce our first quarter high-performance heroes. First off, David Keller, Lane Funeral Home-Coulter Chapel, Chattanooga, Tennessee; Ben Friberg, Heritage Funeral Home and Crematory, Fort Oglethorpe, Georgia; Joe Waterwash, Baird-Case Jordan-Fannin Funeral Home & Cremation Center, Fort Lauderdale, Florida; Liz Coffelt, Becker-Ritter Funeral Home, Brookfield, Winsconsin; Robert Green, Schooler-Armstrong Funeral Home & Chapel; Amarillo, Texas. Raymond Lucero, Berardinelli Family Service -- Family Funeral Service; Santa Fe, New Mexico; Ken Summers, P.L. Fry & Son Funeral Home, Manteca, California; Kristi AhYou, Franklin & Downs Funeral Homes, Modesto, California; and Steve Mora, Conejo Mountain Memorial Park; Camarillo, California.

And with that, we'd like to open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Alex Paris from Barrington Research.

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

As you had said and as we had expected, that Q1 was a tough comp on the funeral services side. Your larger, publicly-traded competitor said the same last week when they reported. If you look at total same-store funeral contracts they were up 3.4% in the first quarter of last year. And then, ultimately, over the course of the year, it normalized, so we had a full year annual death rate sort of impact in line with historical numbers. Likewise, given that your total same-store funeral contracts were down 5.7% in the first quarter year-over-year against that tough comp, I'm assuming you would expect that to normalize over the course of the year. And it really looks like you have easy comps using that metric, with Q2, Q3 of last year both being down year-over-year. And Q4 being pretty flat. So that was your toughest comp of the year. I would assume the comps get easier. And then all of the changes that you've made to the Standard Operating Model and things like that and some of the positive things that you'd noted in your prepared remarks, should lead us to much better results in Q2, Q3, and Q4, for funeral services contract volume. Am I right? Am I wrong?

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

Alex, it's Mel. You're spot on right. I remember this call last year, and I remember getting the question. I don't know if it was from you or not, but because last year, in December and January, the flu season was extraordinarily severe. And there was like a crisis in the country with deaths from flu and all that. And somebody asked me on the question, are you seeing this severe flu season into the beginning of the year? I guess, this was in January. And of course, we were, and I remember saying, look, we've been through this before. I remember January '94, we just bought a group in Chattanooga, North Georgia. The severest flu season. People were dying left and right. We had a 50% EBITDA margin for January. And I said, "Oh my God, I'm rich." Well, that was the beginning of me learning about how unpredictable seasons can go. And by the end of that year I was feeling poor again. I fully expect that by the end of this year, I'll be feeling rich again.

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

Great.

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

We've made a lot of changes. The cops were against us, but people in the business are for us, and there are people who are supporting them, some of whom are in this room throughout the organization, has never been more aligned, more focused, on doing the right thing, and our businesses are responding. I agree with everything that Ben said. And so we're very optimistic from here on.

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

Great. And that's reflected in your rolling 4-quarter guidance?

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

Yes, it is.

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

So how much of a headwind was the cremation rate in the quarter -- or recently? I think, again, your large publicly-traded competitor said, that it had a negative impact, say, of 200 -- it shifted by about 200 basis points in the first quarter year-over-year. What's your experiences in the Carriage Services portfolio of funeral homes?

Carl Benjamin Brink ***Carriage Services, Inc. - CFO, Senior VP & Treasurer***

Yes. So within our portfolio, the delta in same-store apples-to-apples was about 80, 90 basis points increase in cremation rate just over 53%. So kind of in line with the trend, what we've seen, historically. Nothing outside the norm of what we've seen.

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

And we make this point, Alex, what happened to us over the last 2 years, '17 and '18, it wasn't a function of the cremation rate. It was a function of everything that I wrote about in my shareholder letter and that was a symptom that made it look to the outside world like that was a causal factor, but it really wasn't. And what we're seeing now is -- I mean I'm not even paying attention. I am paying attention to what ticks up on the mix here and there, but that's not the driving factor of performance in this company. It's people really believing in this new updated Standards Model and believing they can be successful and being supported to be successful, and having the right people in place. And right now, we've made a lot of changes, including in the first quarter. We continue to focus really hard on discovering opportunities case-by-case, business-by-business, where there is a lot of upside, and we're making moves.

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

And just to follow on there. Refresh my memory. What's the revenue per contract, roughly, on traditional funeral versus the revenue per contract on a cremation? And then, what's been the growth rate in each? In recent years or recent quarter, however you want to answer the question?

Carl Benjamin Brink ***Carriage Services, Inc. - CFO, Senior VP & Treasurer***

Yes. So within our portfolio, it's $9,000 for a traditional burial contract. It's approximately $3,500 for a cremation contract. I'm not going to show the percentages, but over the last 4 or 5 years that cremation contract's moved from about $3,100 to $3,500, and that's where that's been over the last 18 months or so, and that burial contract average has moved from approximately $8,500, $8,600, to that $9,000 level.

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

The delta has remained about the same. The growth rate has gone up higher on the cremation side, just because you have a smaller number.

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

Got you. Not just because you have a smaller number, I also assume, because you are adding services for the celebration of life, things like that, and again, that would be a people-driven process, rather than just...

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

Oh, yes. No, we were really focused on. There are no rules on a cremation, and you don't want to be in the commodity business with direct cremations. So the only way to get out of that business is to create services that are different than your competitors, and we've done a lot of work in this area, with a Carriage portal on the IT side, a lot of additional tools, best practices, innovative ideas being shared across the platform. Very proud of what our support teams and information technology have done.

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

Very good. And then my last question is, given your increased optimism, and the integration issues within the acquired portfolio seemingly behind you now, what can we expect in terms of M&A activity from Carriage Services in the near to intermediate term?

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

We continue to look at opportunities, and we're not out of the game. We have updated the criteria, strategic criteria, so we're more apt to be vetting a business and then applying the right kind of multiples to the future based on the likelihood that, that business can grow at a compounded revenue growth rate 2% to 3%, and if they can do that, we'll get 4% or 5% compounded growth rate in EBITDA over our first 4 or 5 years, creating a lot of value. We're looking, and I'd say we got a pipeline of acquisition candidates, some of which are high-quality and building relationships, and stay tuned.

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

And has the number of opportunities increased, decreased, or stayed the same, over the last period of time? Say, last year or so?

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

Well, it's been interesting because we went into a total operating mode, let's say, and collapsed the acquisition group, but reinvigorated that team with more flexibility, and now we have Shawn Phillips, who went back to heading the Central Region as regional partner, also still wears that hat, part-time. I also have that hat, part-time. We all have that hat, part-time, some of what we now call the [Foil] group. So we're going to change our approach there. And make it more adaptive to and customize the approach. We'll have Standards Council members sometimes go with the team. So I think, we're going to be more effective than we've ever been in the past. And the level of activity I would say has continued to be good. We turn down deals more often than we do more work on them. But right now, we have a handful of quality candidates. And the best news of all is we're not -- from what I can tell, we're not having to get deals through auctions.

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

Very good. And then, Ben, one last question. Do you have a target for debt-to-EBITDA? I think you just said it was at 5.2x by year-end or within a period of time?

Carl Benjamin Brink ***Carriage Services, Inc. - CFO, Senior VP & Treasurer***

Nothing specific, I would say leverage will improve through improved operating performance. I think we can make meaningful progress down to that 4.5x range in the next 12 to 18 months. But I think the focus is, improved operational performance and a lower leverage profile will follow.

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

Yes. Alex, on this point, we didn't expect to have to deal with what we dealt with, starting in the middle of the third quarter of last year. But once it needed to be dealt with, I mean, we went all out. There's only one way to do something, and that's to do it deep, do it broad, and do it right. The best you can define right. And even when you do that with a plan, which we did, through year-end, you then start the execution phase and you begin to have other weak links show up. Both in individual businesses and in the corporate organization. So we continued to make changes throughout the first quarter. What that means is, expectations were very low out there in the market, vis-a-vis Carriage. Otherwise, our price wouldn't be what it is. We understand that. And so we've been through this before. We went back and looked at '11, and then, what happened '12, '13, '14. You'll see what I think will happen going forward.

So in terms of capital allocation, and debt policy, and leverage, and things like that, I would say this is the time when we really focused on, first of all, getting our operating results way back even beyond what they were to peak before in '16, even beyond that. And that's in Cemetery and in Funeral Homes. While we do that, and we're not pessimistic about that, it's only a matter of when, we will look at various ways to create value, intrinsic value in the company that will show itself in terms of market value for shareholders. But it won't be bowler-played, it won't be formulaic, it'll be more opportunistic and entrepreneurial.

Operator

The next question is from Duncan Brown from Wells Fargo.

Duncan Brown ***Wells Fargo Securities, LLC, Research Division - MD and Senior High Yield Health Care Analyst***

Following up on the M&A question, can you comment anything on valuations and multiples, and how that's looking? Maybe how that's changed over the last bit?

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

This is Mel. It's a tricky question and evaluation is going to change case by case, depending on how big the business is. The bigger, the more valuable, the better market it is. The more strong competitive standing it has, the more likely you are to grow revenue at a very high compounded rate versus hanging on to your revenue, hoping it would be stable. So it's all over the place depending on the criteria. And to throw out a simple multiple of EBITDA would be misleading because that's not how we look at it. But having said that, we're probably in the range of 6 to 8, somewhere in there depending on how fast revenue can be predicted to grow in the future.

Duncan Brown ***Wells Fargo Securities, LLC, Research Division - MD and Senior High Yield Health Care Analyst***

Great. In the initial comments on, I think, Ben did on the Cemetery side, that you've invested in heavy lifting, I think you said, on people and infrastructure. And that was flattened with a relatively tough comp. I wondered if you can provide a little more color on what's going in the Cemetery side and for the outlook there.

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

Cemetery side has the greatest upside in the history of the company, right now. And I would say that will begin to be realized. We will look at some structural changes in the organization to make sure that when it shows up, I mean high performance, that it can be sustained. The problem in the past has been, we can juice it. And then, it will last 6 months, 9 months a year, sometimes, maybe a little more, and then it will slide again. We don't want that to be the case. And I think we learned a lot over the recent past. I think you'll see a big difference between the past in our Cemetery performance going forward. We've got about 8 or maybe 10 larger businesses, and that's really where you can move the meter when you get the inventory product availability, the sales teams, the incentive structure, the system of recognition and constant activity, followed and executed. And I think we're real close to getting all those components in place, and now we're working on a structural system that will make sure that it's sustained, but I think you'll see, from here on out, higher performance on our cemeteries. And they will be very accretive.

Duncan Brown ***Wells Fargo Securities, LLC, Research Division - MD and Senior High Yield Health Care Analyst***

Okay. And maybe just a little more on that. I mean so it sounds like some changes in people and infrastructure. Has there been -- I don't know -- you have some newbuilds or additions that you can highlight or talk about?

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

The simple thing is, once you change leadership, operational leadership, and you find out that things had been put in place that were -- you can't do that, you can't do that. If you do this, this is what you get paid, but no more, and this, and that, you demoralize any organization, but especially a sales organization. And this is primarily what we've found. And so we just got rid of all the reasons not to be able to achieve and with no limit on what you can get paid, and turn them loose with product and support. And when you do that, and you mean it, and you got good players in place, look out. You're going to get what you deserve.

Duncan Brown ***Wells Fargo Securities, LLC, Research Division - MD and Senior High Yield Health Care Analyst***

Okay. And then last one for me. I guess in the quarter, financial revenue was down a little bit more than I might have expected, given the market strength. And wondering if you can just comment on that?

Carl Benjamin Brink ***Carriage Services, Inc. - CFO, Senior VP & Treasurer***

Yes. No, I think it kind of shows kind of that it's not a one-for-one relationship between what the stock market is doing and what our financial revenue is going to be. Some of that is kind of onetime. It'll kind of normalize as we go through the year. We do have a little bit lower allocation to reoccurring fixed income. So that played a little bit of role in cemetery perpetual care earnings. But again, we expect that to kind of normalize as we go through the rest of the year.

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

Yes. It's Mel. We backed off at the right time last year. Ben went heavy, withdrew money from primarily the equity side and had a big pile of cash when the market turned south. We started putting that money back to work, the right time, and we participated fully plus some in the big comeback at the beginning of the year.

Operator

The next question is from Chris McGinnis from Sidoti.

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

I was just wondering if you could maybe highlight -- I think Mel just touched on some of it, but just the changes, structurally, how they're -- how the people were responding to that? What is the biggest thing that they are responding to? Is it the pay? The change in the compensation? It sounds like you're giving them a little more opportunity to better compensate themselves. There's a lot of changes, obviously, in the last few months. Just talk about what you think the employees are responding to most?

Carl Benjamin Brink ***Carriage Services, Inc. - CFO, Senior VP & Treasurer***

Yes. No, I think it's less about the change in incentive structure, and it's really about the change in mindset and attitude. As Mel alluded to, breaking down the barriers and breaking down all the reasons why people were being told no and finding ways for people to be told yes, and to give them opportunities to [stream] their business. I think, a lot -- we find that people who've bought in across the portfolio, the morale has been tremendous. The feedback has been fantastic and we expect all of that to show up in the results moving forward. There's a quiet sense of urgency and resolve across the entire organization, and people want to make sure that they live up to the expectations that we have for all of us. So I think, that's what people are responding to more than anything else.

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

Chris, Mel. I'm looking at our quarterly -- I'm looking -- numbers to me are important. Not just because of financial performance, but they're important because they're a language. And what I've learned in my career is that certain numbers tell me a lot about the morale, what's going on in our businesses. This is a language of how people are doing, how they're feeling, whether they're aligned, whether they're stretching, whether they're focused. And if I'm looking at the last year, first quarter last year, which was a strong volume quarter, we had a 30.6% adjusted consolidated EBITDA margin. 30.6%. In the second quarter it was 23.9%. I mean, that's pathetic. That's pathetic.

In the third quarter it's 24.4%. That's pathetic. That's pathetic. And then the fourth quarter, it was 25.2%. Okay, we were in the middle of all this stuff. We didn't know what to expect. We're 25.2%. Well even though we didn't have the volumes in the first quarter this year, we're 30.2%. 30.2% versus 25.2%, versus 24.4%, versus 23.9%. I can tell you those 3 quarters, our people were demoralized. They're not demoralized anymore.

And look, I hear this, they send feedback when they're really highly motivated and aligned. They will let you know it by feedback. When it goes silent, you get these damn low numbers here. And as soon as you get these low numbers, you've got a problem, you've lost touch with your people. And we're no longer out of touch with our people, and they're giving us incredible feedback about how they're feeling about the company. The changes in the company. What they're willing to do, to do their contribution for the company, broadly. And this is what we're hearing.

And so that will convert itself into high margins. I promise you. And this is just the nature of knowing your company, and knowing your people, and knowing how it gets converted in the numbers when it's bad. And the other way around is getting converted into high numbers when it's good. So I want us to get back to a point where we're headed toward an annual EBITDA margin of 30%. We want to break that barrier. Never been broken before in the history of the company, or the industry. That's where we're shooting for, not some quarterly number.

We're not counting on luck, but we'll take it.

Operator

I am showing no further questions at this time. I would now like to turn the conference back to Mel Payne for closing remarks.

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

Thank you very much. Great questions. I will not elaborate on what I just said, but we feel great about our company. We've got a lot of support from our partners in the field, our [Foil] group here in Houston.

If you want to find out how much of what I just said is visible, you're going to have to come here and visit our people or visit our businesses. And we're an open book. We invite everybody who's got an interest in being a long-term investor to get to know more and dive deep. Don't just look at the numbers. And we welcome your investment in our company, and we won't let you down.

Thank you for your -- for calling in. Bye.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation, and have a wonderful day. You may all disconnect.