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CSV - Q2 2017 Carriage Services Inc Earnings Call

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Carriage Services Second Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to turn the call over to your host for today's conference, Ms. Viki Blinderman, Senior Vice President and Principal Financial Officer. Ma'am, you may begin.

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

Thank you, and good morning, everyone. We're glad you can join us. We would like to welcome you to the Carriage Services conference call. Today, we will be discussing the company's results after the second quarter of 2017, which was released yesterday after the market closed.

Carriage Services has posted the press release, including supplemental financial tables and information, on its investors page of our website. This audio conference is being recorded and an archive will be made available on our website later today through July 31.

Replay information for the call can be found in the press release distributed yesterday. On the call today from management are Mel Payne, Chairman and Chief Executive Officer; and Ben Brink, 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 will make forward-looking statements in accordance with the safe harbor provision of the Private Securities Litigation Reform Act of 1995.

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

Forward-looking statements, assumptions or factors stated or referred to on this conference call are based on information available to Carriage Services as of today. Carriage Services expressly disclaims any duty to provide updates to these forward-looking statements, assumptions or other factors after 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 would like to turn the call over to Mel Payne, Chairman and Chief Executive Officer.

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

Thank you, Viki. In my recent shareholder letter, I made the statement that we used to think of the first 5-year starting in '12 is Good To Great Journey. And in the last 2 years of that 5-year timeframe, we began to think differently over a much longer period of time. And we changed it to a Good To Great Journey that never ends because there were still so many ways across our consolidation and operating platform that we could get better.

The second quarter is a case study in a glass half full quarter with so many opportunities to improve our company over the next 6 months and over the next 4.5 years within the second 5-year timeframe of our Good to Great Journey.

I will let Ben go over some of the details of the quarter and then, if there are questions afterwards and some of the ways we can get better and are working in highly focused on doing so, be glad to answer those. Ben?

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

Thank you, Mel. Carriage Services second quarter and year-to-date results reflected weak operational performance in a concentrated set of businesses in both our same-store Cemetery and Acquisition Funeral Home portfolios, along with increased investment in quality people and teams that are key to our continued long-term success.

In the second quarter, Carriage produced record total revenue and Field EBITDA of $63.9 million and $25.3 million, respectively, while adjusted consolidated EBITDA declined 7.1% to $16.5 million. And adjusted diluted earnings per share declined 18.9% to $0.30 per share compared to last year.

Year-to-date total revenue increased 5.4% to $132 million and Field EBITDA increased 3.8% to $54.8 million, while adjusted consolidated EBITDA declined 1.6% to $37.1 million, adjusted consolidated EBITDA margin declined to 28.1%, adjusted net income decreased 4.6% to $13.6 million and adjusted diluted earnings per share decreased 10.7% to $0.75 per share.

The year-to-date decline in adjusted diluted earnings per share can partially be attributable to our improved non-GAAP reporting and an additional 1.2 million GAAP diluted shares related to our outstanding convertible notes.

Compared to the first half of 2016, the differences in these 2 items had a negative $0.10 per share impact on our adjusted diluted earnings per share.

Our same-store Funeral segment continued the momentum from the first quarter as year-to-date revenue and Field EBITDA increased 1.7% and 3%, respectively.

Our managing partners and their high-performance teams continue to make incremental improvement in Field EBITDA margin, which increased 50 basis points to 39.6% through the first half of the year.

The cremation rate in our same-store Funeral portfolio increased 130 basis points to 52.4% while our average revenue per funeral contract increased slightly to $5,346.

Year-to-date Acquisition Funeral home revenue increased 53.6%, field EBITDA increased 45.9% to $7.1 million and Field EBITDA margin declined 200 (sic) ˆ basis points to 40.9%.

The decline in Field EBITDA margin is entirely concentrated at 2 acquisitions we made in the second half of last year. We fully expect margins of these businesses to improve over time as they become fully integrated into the Carriage framework of operational support and learn how to execute within our unique and differentiated (inaudible) operating model for long-term operating and financial high performance.

We're confident the near-term future performance of these recent acquisitions, given the performance of the rest of the Acquisition Funeral home portfolio.

Disregarding acquisitions we made last year, the remaining businesses acquired between 2013 and 2015 grew revenue by 6.2% and grew Field EBITDA by 12.4%, with Field EBITDA margins of 45.6% in the first half of 2017 compared to last year.

The second quarter financial results in our Cemetery segment continued from the first quarter a trend of weak operating performance, particularly preneed property sales in a concentrated group of 4 of our larger cemeteries.

Through the first 6 months of the year, Cemetery total revenue and Field EBITDA decreased 2.3% and 13%, respectively, with field EBITDA margins declining 360 basis points to 29.5%.

These declines were entirely attributable to a 13.7% decrease in preneed property sales. We have or are in the process of taking the necessary steps to improve the operating and financial performance in these 4 particular businesses and across our entire cemetery portfolio and expect to report improved results as we move through the balance of the year.

Year-to-date overhead expenses have fallen $1.2 million. And overhead, as a percentage of revenue, has dropped 13.4% versus 15.1% in the first half of 2016.

Overhead cost in the second quarter increased $1.2 million compared to last year due to our investments in quality people we've made in 2017, a $300,000 increase in severance expenses and an increase in costs related to our proxy and shelf registration.

Throughout the first half of 2017, we've taken the opportunity to selectively add to our high-performance corporate development, information technology and operational support teams.

We view these 3 areas as critical components for Carriage to take full advantage of the increased level of consolidation activity we see within our industry over the next 5 to 10 years. And we're happy with the quick progress we've made in adding to those teams.

Reported adjusted free cash flow declined by approximately $10 million during the first 2 quarters of 2017. The decline in reported adjusted free cash flow was due to the second quarter operating performance, the change in non-GAAP reporting methodology we made this year and timing differences related to maintenance capital expenditures and federal tax payments compared to last year.

Given our view of the current and near-term operating trends, along with the permanent overhead expenses being higher than we originally expected, we are reducing our rolling 4-quarter adjusted diluted earnings per share outlook to a range of $1.65 to $1.69.

Thank you for the opportunity to join us on the call today. And we look forward to reporting our results, again, in October.

And with that, I will turn the call back over to Mel.

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

Thank you, Ben. Listed below in the press release on Page 2 are the High Performance Hero Managing Partners during the second quarter. And I'd like to call them out by name. David -- Dave DeRubeis, Cody-White Funeral Home, Milford, Connecticut; Patrick Schoen, Jacob Schoen & Son Funeral Home, New Orleans; Jason Higginbotham, Lakeland Funeral Home, Lakeland, Florida; Heather Simons, Hubbard Funeral Home, Baltimore, Maryland; Randy Valentine, Dieterle Memorial Home & Cremation Ceremonies, Montgomery, Illinois; Bob Thomas, Malone Funeral Home, Grayson, Kentucky; Pam Parramore, Baker-Stevens-Parramore Funeral Homes, Middletown, Ohio; Cliff Pope, Havenbrook Funeral Home, Norman, Oklahoma; and Scott Glover, Alsip & Persons Funeral Chapel, Nampa, Idaho.

And with that, I'd like to open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question goes to the line of Alex Paris with Barrington Research.

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

I got a couple of questions. First of all, I'll start with Cemetery. By -- versus my estimate, the short fall in Cemetery was 100% of the variance versus my estimate for total revenue. Cemetery has been an issue in the fourth quarter and in the first quarter. And in the first quarter, you talked about replacing some of the leaders in those largest cemetery properties, and you felt good about the changes. Is it an issue or it's just going to take a little time for those guys to gain a little traction with some initiatives? What's going on there? And are there any other changes that need to be made to get that growing again?

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

Yes. This is -- the cemetery when you find weakness. And you'd have to go back and look at our history. This has happened once before in 2008 in April. I basically said, look, we're not very good at the cemetery sales business. And we basically wiped out all the sales managers and key people at our largest places and started over rebuilding. It took us 8 months. But to tell you what happens when you do it right, Alex, the great market crash, recession hit at the end of '08. And everybody said, you won't be able to make any preneed sales in your cemeteries. We had a record first half in 2009 in cemetery property sales. So we've added some talent on the operating team with sales expertise in the last few months. I fully expect by the end of the year, and I think it will take that long to rebuild these teams. There are only 4 large cemeteries where this is an issue. But those 4 move the meter. And one of them is Rolling Hills, that's our biggest one. And it really moves the meter. And so, I fully expect by the end of this year, we'll have our sales teams repopulated with talent. Leading into 2018, we'll be hitting on most cylinders again.

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

Okay. Was the issue primarily preneed sales, again?

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

Yes. There was an advanced planning team at Rolling Hills that basically got wiped out. And that was a big portion. It's all preneed property sales, absolutely. And then, we had some turnover down at seaside in Corpus Christi, which is a big cemetery and then a couple of others. So these are things that you can repair. It's not permanent. We're all over it. Believe me, when I say, we're all over it, that means we are all over it. There's a little stress being applied, little tension here, little (inaudible) leadership with edge. So it will get better, Alex.

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

No. I believe you. I wouldn't expect anything less from you. But...

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

Thanks for your understanding.

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

Is that where the bulk of the severance comes from the $300,000 that Ben called out?

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

It's kind of a mix across the board, Alex. It's a little bit in Cemetery and elsewhere so.

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

One of the things, Alex, and if you don't mind, I will take this. We had a midyear review. I had a midyear review with all the senior leadership team. And you go 5.5 years and you create a lot of value, everybody is happy and Good to Great Journey and all that. Well, that's never good enough. So you do a midyear review halfway through the sixth year and you say, look, whatever we thought, we were good at before. I'm telling you we're not good enough. And so I would say right now you got this team in the last little while perked up, energized, ready to play at a much higher level, because that is the requirement. And there is not an option. So I think this has been actually a good thing, a wake-up call, some weakness, a little humbling pie. And I think this is going to be energizing for the entire team. Our Field is good except in a few places that we mentioned. But overall, the morale and the team out in the field, the managing partners, the businesses are high morale. We had our MP meeting in June. And we're ready to go to end the year strong with these few areas of weakness. We'll get those -- if it were broad, that's one thing, but it's not. It's highly focused and concentrated. And it's exciting opportunity for all of us to take our game to a new level.

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

Great. I hear you. And I know you don't like focusing on 3 months at a time and that sort of thing. Your response to me, Mel, was as you fill out these sales teams over the course of this year, you will be well positioned for next year. Should we expect any, I guess, Ben kind of alluded to this, should we expect some at least sequential improvement, over the balance of this year?

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

I'd be disappointed if we don't, but I can't. It is just a quarter. But it was a wake-up quarter. I remember you saying it's a report card. Well, we didn't get a very high grade. And believe me, I don't like not getting high grades. And as a largest individual shareholder, that's unacceptable. So I think we'll get a better grade from here on out. I just can't predict exactly what that incremental improvement will be.

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

Okay. I hear you. So I'll leave it at that on Cemetery. It sounds like you're aware of the issues and you've addressed them, and we'll wait and see how it improves going forward.

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

Let's just say we're taking no prisoners.

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

All right. Moving on to the acquisition EBITDA margins. I think, Ben, you called out it was just a couple of the most recent acquisitions that you made in the second half of last year. What have you done there to improve expectations for the future?

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

Let me speak to that, Alex, because I have been working with Shawn and his team. I've actually been out with them. We got a good track record over the last 5 years, but it was spotty. It wasn't a predictable number of acquisitions sort of that you can predict out in any kind of way. But we made some very, very good acquisitions. Now Shawn has got a new team, and they're really out seeding relationships across the country. And the interesting thing about this industry is, it is so local and not everybody is in some kind of a national association and following all the things that go along with the public companies. And now there are only 2 of us. So a lot of the times, they just don't have an awareness of the uniqueness of our framework, the standards models and all of that. So we made a big acquisition. And it had been around for 9 months. And we finally got it across the finish line. And so we didn't have it fully vetted out in terms of integration plans and things like that, because we'd had a lot of difficulty trying to get it across the finish line. And the integration plan took -- was delayed until after we got it across the finish line and closed it. That will happen now. But this has also been a highlight on how we can do better when we get a business that we vet through 10 strategic criteria that we think fits and has a higher revenue growth profile both in terms of volumes and pricing power and revenue over 5 or 10 years. We are getting much better at before the closing, building integration plans and having a common commitment to execution of an integration plan to bring that business up to what we call a high level of standards achievement, meaning above 70% or 80%, which then leads to highs in sustainable financial performance. So we -- as we speak are perfecting. If not perfecting, then we are improving dramatically. The pre-closing development and commitment by both parties to an integration plan and the accountability that they have to us and we have to them after the closing. And I think you will see a huge difference in that over the next 5 years.

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

Great. So given all these pre-closing measures that you're taking with acquisitions in some form of negotiation pipeline, does that contribute to delaying a closing? Or does it not have any effect?

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

Absolutely. No question. We're having -- what we've learned the hard way is someone really needs to understand us. And they can't understand us if they never leave their hometown. If we're just communicating with them in writing or verbally, they can't fathom how different this is. So we're requiring now that they visit 1 or 2 of our managing partners for a couple of days, see how this works, see all the support that is provided by Houston, just see how their business will get better. Even though it's a good business, it will absolutely get better once it's fully integrated into our support framework. And they don't have to worry about all the stuff that a typical owner has to worry about. HR, IT, legal, regulatory, all the stuff. We do all that for them and we eat it. We don't allocate any of that to them. And our incentive programs are incredibly generous. And so we build a 5- and 10-year plan of the future before we do an acquisition now. And we have them commit to that, because we want them to win this what we call this Good To Great 5-year value creation award, which is incredible. And in order to do that, they have to grow revenue at 2% compounded annually or higher. And they had to do it at sustainable margins within the margins that we -- that I wrote about in the shareholder letter in their grouping. And these are not low margins. They're EBITDA ranges. So when you get them to visit our businesses, see how our best managing partners are executing in this framework and then come to the home office and see all the support. This takes a little time that we didn't used to build into the process. And that time will pay off in spades.

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

Yes, I don't doubt it. So that brings me to my last question, the acquisition pipeline. I noticed that there's not any LOIs as part of your rolling 4-quarter guidance. We haven't done any acquisition year-to-date undoubtedly. And I agree with you that there is a great opportunity over the next 5 years and you're positioning the team to be prepared for that. Nearer term, what does the pipeline look like? And what are your expectations there?

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

There is a lot of activity, there's a lot of activity. We have 4 people, Shawn and 3 other members of his team, 2 very active out in the field, calling every week, building relationships. We have 3 LOIs outstanding. That doesn't mean that they will all be signed and closed. They're all good businesses. And they're in various stages of processing. And yet, we wouldn't have those LOIs even outstanding if they hadn't gone through the vetting and the criteria ranking. And we think they're a good fit. Do I think some of those will close? Yes. When? I don't know. If on the outside chance, I don't want to jinx it, there is some kind of tax reform somehow magically at the end of the year or early next year. I think that could lead to an acceleration of consolidation over the next 5 years. Because a lot -- what we found is lot of these businesses still don't have the ideal corporate structure for after-tax proceeds upon an exit, believe it or not.

Operator

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

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

Just one kind of follow up in what you were saying. I was just wondering if you could talk a little bit about how long does it take for a new (inaudible) operator to kind of learn the culture and get comfortable (inaudible) making from the way he traditionally ran the company? And are there any pushbacks to that when they come in and or is it more (inaudible) embracing relationship?

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

That's a great question, Chris. It's case-by-case. I'm thinking back over the different acquisitions we made just over the last 5 years. There have been some -- some businesses are already being well run. In terms of once they close with us and we integrate, some are out of the gate just on fire. Now, typically, that's with a managing partner, I can think of a big business we bought in Chattanooga that had 2 really nice size chapels, one in East Chattanooga in Tennessee and one just South, Chattanooga in Fort Oglethorpe. And the former owner had a key guy and then he had his son, so each one became a managing partner. And these businesses almost from day 1 flourished. The same with a business in Clarksville, Tennessee, the former owner Mike [Parchman]. And then a business in North Carolina, [Bryte], where we recruited a guy, but he had worked there before. He hit the ground running. And these are been high-performance almost from day 1. There are others who joined us that took a year or so. Then -- and yet now they're very high performing, really just hitting it out of the park. So the alumni over the last 5 years, except for these 2 recent ones, there aren't any exceptions in there. They are all high performance. The ones we bought in New Orleans 4 and 2 in Fairfax and 14 from SCI, they're all, except one small one in Fairfax, they're all growing and achieving. So like Ben said, if you exclude these 2, the performance really is extraordinary as a group through the first half of the year. And so I'd say our goal going forward is to have the ones that we know will struggle, because we can look at how it's being operated, how it's being staffed, have that integration plan specifically outlined before the closing and committed to. And we're looking at one of those now. And if you've got a really great business and especially a bigger business, you don't want to rush that and overdo it. So I'd say you want it fully integrated within a year. But a lot of them will get that way sooner. Some of them right out of the gate. But most, probably within 6 months.

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

And are you still adding to that team or to the M&A team, or you feel really solid with the 4 that you mentioned previously?

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

No. We have the team. We have 2-analysts -- acquisition analysts and 4 -- we have one support person. We build profiles on markets. We're building profiles on individual businesses that we think will fit within each major strategic market. We've been building out this plan and then focusing and allocating the human resources on the ground to build the relationships within the markets we want to build groups within.

Operator

And our next question comes from Barry Mendel with Mendel Money Management. If your phone is on mute, please unmute your phone.

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

Don't be shy, Barry.

Operator

All right. It might be a bad connection. I'm not showing any further questions. So I'll now turn the call back over to Mel Payne, CEO, for closing remarks.

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

Thank you very much. We had another quarter. The first weak quarter we have had in a long while. And it won't stay that way. So we're all excited here at Carriage. We have a lot of people on the phone from Carriage in our businesses. I want to say hi to all of them and keep it up. The Good To Great Journey will continue. And we'll continue to report our progress to our investors as we go. Thank you very much.

Operator

Ladies and gentlemen, this does conclude the program. You may now disconnect. Everyone, have a great day.