CARRIAGE SERVICES
"Fourth Quarter 2011 Earnings Results Conference Call"

February 23, 2012, 10:30 AM ET
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OPERATOR: Good morning, and welcome to the Carriage Services fourth quarter 2011 results conference call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn the conference over to Alexandra Tramont. Please go ahead.

ALEXANDRA TRAMONT: Thank you and good morning everyone. I would like to welcome you to Carriage Services conference call. We are here to discuss the company's 2011 fourth quarter and full-year results, which were released after the close of the market yesterday. Additionally, Carriage Services has posted supplemental financial tables and information on its website at www.carriageservices.com. If you would like to be on the email distribution list for future Carriage Services releases, or if you would like to receive a copy of the press release, please call my offices at FTI Consulting at 212-850-5600 or visit Carriage Services' website.

This conference is being broadcast live over the Internet on Carriage's website, and a subsequent archive will be made available. Additionally, in a few hours a telephonic replay of this call will be made available and active through March 5. The replay information for the call can be found in the news release distributed yesterday.

With us from management are Mel Payne, Chairman and Chief Executive Officer; Bill Heiligbrodt, Vice Chairman; and Terry Sanford, Executive Vice President and Chief Financial Officer.

Today's call will begin with formal remarks from management, followed by a question-and-answer period. Please note that in this morning's call, management may make forward-looking statements in accordance with the safe harbor provision of the Private Securities Litigation Reform Act of 1995. I would like to call your attention to the risks associated with these statements, which are more fully described in the company's annual 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 the 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-GAAP financial performance measures. Management's opinion regarding the usefulness of such measures together with a reconciliation of such measures with the most directly comparable GAAP measures for historical periods are included in the press release and the company's filings with the Securities and Exchange Commission.

With these formalities out of the way, I would like to turn the call over to Mel Payne, Chairman and Chief Executive Officer. Mel, please go ahead.

MEL PAYNE: Thank you very much. Thank you for joining our call this morning to report our 2011 results in our fourth quarter. Simply put, the year 2011 was the best year in Carriage's 21-year history. We added Dave DeCarlo and Don Patterson to our Board of Directors during the year and now have a completely transformed and highly engaged board since February 2009. Bill Heiligbrodt, whose relationship with me dates back to 1975 when we both worked at Texas Commerce Bank and who loaned me the money to start Carriage in 1991 when I knew absolutely nothing about this industry, joined the company full-time in September 2011 as Vice Chairman of the Board. He and I then split the executive officer responsibilities into two groups, with Bill having financial reporting and strategy, investor relations, legal, and acquisition strategy and execution. I have responsibility for our trust funds, operations, human resources, leadership and development, and Carriage's vision and culture. Our partnership is working beautifully, and the results began to reflect the amazing amount of progress made across the company during the fourth quarter, starting on October 17, 2011. We ended 2011 with a strong performance quarter and a record year in spite of unusually low death rates, especially in December. For the details and an explanation, I will now turn the call over to Bill.

WILLIAM HEILIGBRODT: Okay, thank you, and Mel commented on our relationship, and I was going to add to that in that my records show our relationship goes back 40 years rather than 37 in that we worked actively closely together over at least 30 of those 40 years. So it's a pleasure to be here today, and first I'd like to say that the improvement in our operating performance of both our funeral homes and cemeteries has continued to enhance the intrinsic value of Carriage in 2011. This has been augmented by the continued strong flow of investment results into revenues of our business from our trust fund portfolios. Although we are pleased with our improved operating performance of the company this year, as reflected by field EBITDA margins, we're not complacent. We are positioned and our operating managers are prepared to take the company forward to achieving a higher sustainable level of performance that more reflects the earnings potential of Carriage.

Acquisition results reported this year more clearly present the long-term impact that new quality acquisitions can have on our company's performance. This, combined with the improved operating results, is of primary strategic importance and will continue to have a positive impact as we move forward in 2012.

Results for 2011. Revenue — looking directly at our numbers for 2011, total revenue increased $5,690,000 and was driven by a funeral acquisition revenue increase of $8,246,000, 37 percent. This increase offset a small decline in same store funeral volume of a million dollars, or approximately 1 percent. Same store funeral volume has been relatively flat — had been relatively flat through our first three quarters and only decreased during the fourth quarter of 2011, which seemed consistent with other funeral entities. Also of importance, however, is the fact that the combination of our existing businesses and acquired businesses produced an increase in total funeral contracts of 18,062 to 27,663 for this year.

Summary — total revenues were up because of acquisitions. Funeral EBITDA was up over 14 percent at a margin of 34 percent, and we grew numbers of funerals.

Cemetery — cemetery sales were down $1,470,000, or 3.6 percent. Most responsible for this decline is pre-need sales, which is an area of focus for us, and we believe to be temporary in nature. In spite of this decline in cemetery revenue, we were able to achieve greater field EBITDA margins of 24.5 percent compared to 22.4 percent last year, resulting in an actual increase of 5.5 percent, to $9,547,000 in cemetery field EBITDA over last year. Again, emphasizing even though we were down in cemetery revenue, we were up in operating profit and margin.

Investment performance, what can I say? Investment performance over the past few years generated the $14,670,000 financial revenue the company achieved this year, and this same investment performance of our trust portfolios will continue to have a major impact on revenue in 2012. Enough said.

In summary, our field operations for 2011 achieved a 10 percent increase in total field EBITDA of $6,360,000, to $69,929,000, unusual, but true. That was greater than our total field revenue increase of $5,690,000. The results again, a field EBITDA margin increase from 34.4 percent to 36.7 percent. Again, summarizing, field EBITDA for Carriage was up more than field revenue, with again margin expansion.

GAAP earnings per share was 38 cents versus 45 cents last year. The 7-cent decrease in EPS is attributable to $4,200,000 in non-recurring net expenses completely detailed under special items in our non-GAAP unaudited income statement and included as part of overhead. These special items represented 13 cents per share; therefore a more proper comparison of adjusted GAAP EPS would be 51 cents earnings per share versus 45 cents earnings per share last year.

Total overhead expenses of $28,900,000 adjusted for the same non-recurring expenses of $4,200,000 would be up 16 percent or $3,470,000 greater than last year. The major components of that adjusted increase are corporate public company related expenses, increased 401(k) matching, and a new incentive compensation plan for field employees.

Non-GAAP consolidated EBITDA of $50,623,000 is up 10 percent from last year and showed a margin improvement from 24.9 to 26.6. Results — non-GAAP earnings per share for Carriage was 66 cents per share for 2011 versus 54 cents for 2010, an increase of 22 percent.

Cash flow — cash flow from operations, $31 million for 2011, was up 21 percent from 2010 and is about equal to our percentage increase in non-GAAP earnings per share. The major components of this improvement previously discussed were improved field EBITDA margins, number one; number two, acquisition revenue; number three, recognized financial revenue; and number four, financial withdrawals from our trust.

Results — the results were we financed all our acquisitions internally, provided for growth and operations through the new capital expenditures, repurchased $3,100,000 in convertible subordinated debentures and 126,000 shares of our common stock, and paid dividends to our shareholders.

Fourth quarter 2011; looking at the fourth quarter, total revenues were down slightly. Acquisition revenue again was up 23 percent, while same store funeral revenue was down 3.6 percent. All performance margins improved, as shown in the non-GAAP unaudited income statement, with our total field EBITDA up 9 percent to $17,623,000 at a margin of almost 37 percent continued improvement.

Fourth quarter GAAP EPS was 2 cents versus 12 cents last year. This, again, as I explained in the comment for our annual 2011 results, was attributable to non-recurring expenses of $3,240,000 in the quarter, amounting to 11 cents per share, and was composed mainly of discontinued stock-based executive incentive compensation plans and termination expenses for employees no longer with the company. The decline in non-GAAP EPS from 17 cents to 11 cents this year was primarily the result of a decline in withdrawable trust income of $2.4 million, equal to 8 cents a share.

In conclusion, let me say all of us at Carriage are focused on the key drivers of value creation of our company. Next year should see continued improvement in margins from our operations, new acquisitions with strong contributions falling to EBITDA, continued strong investment — excuse me, continued strong investment performance in our trust, and a decrease in non-recurring costs seen this year at the corporate level.

With that, I'm going to turn it back over to Mel.

MEL PAYNE: Thank you, Bill. The year 2011 ended the first 20-year history of Carriage. It's been an interesting history, but I'm glad we're at this point and not some other point back in history. Over the last eight years, and especially over the last four months, we have evolved into a company that is positioned in every way to have a long and sustained period of high operating and financial performance. We have therefore themed this year as "Carriage Services 2012, A New Beginning," and we hope you will be along for a journey that over the next five years is designed to take Carriage from being a good company in 2012, as defined by our performance in 2012, to a great company within five years, also defined by our performance. We hope to have fun. It should be meaningful for those involved in contributing to our success, and we appreciate very much your attention and support. Thank you for calling in — into this call. Any questions?

OPERATOR: We will now begin the question-and-answer session. To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. At this time, we will pause momentarily to assemble our roster.

The first question comes from Nick Halen of Sidoti & Company. Please go ahead.

NICK HALEN: Good morning, guys.

WILLIAM HEILIGBRODT: Good morning.

NICK HALEN: So the first question I had was just regarding the data acquisition pipeline. I mean, it seems very full, and you guys seem really optimistic about it also, but the question I had was just in terms of the multiples that you're seeing now, I guess, just in the industry in general, I mean, as the quality of the potential M&A targets continues to increase, I mean, is that affecting the multiples that you guys have been paying for acquisitions?

WILLIAM HEILIGBRODT: The — this is Bill Heiligbrodt. The acquisition pipeline is strong. It offers us an opportunity to be extremely selective. We're trying to identify businesses that will improve our overall businesses in Carriage. We're trying to find businesses that have some resistance to certain characteristics of the funeral industry, and what we're seeing is an opportunity to buy good businesses at reasonable numbers, and I think if you'll look at those non-GAAP unaudited income statements, which we call our trend report, which we use to manage this company by, you'll see what kind of margins we're getting. The prices are reasonable, and they're certainly — and we're trying those to a very high return, cash on cash, first-year result, plus significant earnings per share pickup with each acquisition

We had — we just recently announced yesterday a close of another acquisition this year in Pennsylvania. We announced the close of a very nice acquisition on Long Island in the fourth quarter. And we have another very nice acquisition project that we're working on now where we do expect a possible close during the month of March. And so we're looking for a very strong year this year, and obviously these acquisitions have a significant effect on our operations. And we'd be happy to discuss that with you privately at any time if you'd like to look at what we're doing and what we're paying on a more direct basis. That — we'd be happy to talk to you about that.

NICK HALEN: Okay. And now that — the acquisition that you just mentioned that you're expecting to close in the future, I mean, is that baked into your guidance for the year, or is that not — is that excluding that?

WILLIAM HEILIGBRODT: That is not in our guidance for the year.

NICK HALEN: It's not in the guidance, okay. And now just — I'm not sure if I'm looking at this right, but just in terms of the trust funds, did you guys lower your exposure to equities in the quarter and I guess looking out across 2012 — I mean, are you expecting to make any meaningful asset reallocations?

MEL PAYNE: No. This is Mel. When S&P downgraded the U.S. on August 5 and the market crashed that following Monday, everybody ran for the safety of Treasuries, and that continued — the volatility in the market continued to generate tremendous risk aversion from that point through the end of the year with a prediction that the first half of 2012 would also be volatile, which hasn't turned out to be true. So we did, by design and by strategy, reduce our equity exposure hugely and redeployed the proceeds into high-yield and fixed income securities, too-big-to-fail preferred stocks, which took our recurring annualized income, which will tremendously benefit the perpetual care funds as well as all the other funds, not only with much higher levels of income, which went from 7.9 to 12.2 recurring annual income, but we've also already gotten huge gains in the fixed income securities that we bought, because we bought them at highly discounted prices to par, to a degree that we expect the gains to be greater than the realized losses we took in the equities. So we went to a highly concentrated smaller group of equities. Apple is our biggest position by far and it has been for — since 2008, so we think we made a pretty good move there, and we don't anticipate changing that allocation except modestly during the rest of this year, and we'll take the income that now is flowing in quite frequently and in big amounts, and put it into a few equities that we still like a lot no matter what the overall economic environment.

NICH HALEN: Great, thanks, guys.

OPERATOR: The next question comes from Clint Fendley of Davenport. Please go ahead.

CLINT FENDLEY: Thank you. Good morning, Mel and Bill.

MEL PAYNE: Hey, Clint.

CLINT FENDLEY: I wondered if you guys could talk a little bit about the pre-need environment on the cemetery side. I mean, you sound pretty bullish on your prospects for growth there. I know you all have been kind of changing up your operations a little bit on that side, and if you also could just maybe provide a little bit of color on how you were able to drive the EBITDA growth in that segment in light of the 8 percent revenue decrease that we saw.

MEL PAYNE: Okay, the cemetery business, as you know, has a lot more moving parts, and starting on October 17, as I mentioned, we initiated a complete review of the last ten years of history, both in the cemetery business and in the funeral business, and by the end of November, on the funeral home side we had launched — relaunched a refreshed standards operating model with new — each business is now in different groupings and — by peer group, and we updated some of the margin standards and so on; and that was rolled out at the end of November, and we saw an incredible response to that — to that project, to the degree that December looked better by a mile than any other month in the year, and that continued over into January. So we think we have traction on all the new standards operating model for our funeral homes.

I looked at the standards model for the cemeteries, and it had grown static, complex, and so I waived all of that to start off 2012. We reached out to a group of industry professionals, not in Carriage, really with Dave DeCarlo's relationships, who introduced us to some really wonderful people, great operators. So we went to school, and we have launched some new programs in the cemetery business, particularly in our Florida cemeteries where we're concentrated and in California where we're concentrated. The early returns — it's too early to have a definitive material impact, but I will tell you that I think by the middle of this year we will begin to see — and certainly the second quarter, some differences of performance, but this is new for us, and we want to go slow, and we don't want to overpromise. I think we can get our cemetery performance back up at acceptable margins, but that might take, you know, it might take six months to be able to tell you this is exactly what we can achieve this year. So I don't want to go there. It's just a different business, and we're going to take our time and get it right.

CLINT FENDLEY: That's helpful, and I know you all have got a very active acquisition pipeline there. Are there any cemeteries that are in that pipeline?

WILLIAM HEILIGBRODT: Yes. It's Bill again. There are, but they're very unusual cemeteries that we think are operating slightly differently than the traditional cemeteries, and we think that there's still a lot of opportunity in that — in that market for us with the right property.

CLINT FENDLEY: Okay. And the last question. I know you guys are reporting a bit later than some of the others in the group, and it's been a very, you know, tough few weeks for volume. Just any color on maybe how things have worked through January and part of February here from a volume perspective?

MEL PAYNE: Well, they were very weak in December. I'm sure you know that. They were very weak in January. There hasn't been any cold weather, no flu season. The seasonality just didn't show up this year. Now, having said that, I do see — you know, I do see by the middle of February things beginning to change, and I will tell you that the way we achieved results in December and January with volumes low was really phenomenal, so when the volumes show up, I would expect the performance to reflect the operating leverage kicking in big time. So we're not hoping that people die because of the flu or any other reason, but we want to get our share, and if we do get our share, based on our portfolio, we think — we think we can do some good with it.

WILLIAM HEILIGBRODT: And, again, I want to emphasize that even though that we're facing those kind of trends, the opportunities afforded us on the acquisition side again have had somewhat of a mitigating effect there, and I want to emphasize again, even with all this happening in 2011, we were still up on funeral contracts, numbers of funerals.

CLINT FENDLEY: Do you think it's safe to say you can — we'll be able to say the same thing for 2012, given the acquisitions that you've already booked, even in light of the difficult volume environments?

WILLIAM HEILIGBRODT: Well, our goal is to be better, Clint, so, yeah, I think it —

MEL PAYNE: It's difficult — I mean, we've had difficult volume environments before, but they don't seem to — you know, this is the funeral business, so by the end of this year, you know, people are living longer and all that, but we don't have any broad market share issues in this company, so we follow that every month, every place, by every competitor. So by the end of the year, I'd expect it to all even out. Now, I can't tell you whether it's going to be up 1 percent, down 1 percent, but I don't think it will be much different than that.

WILLIAM HEILIGBRODT: Let me address that acquisition point that you made, Clint. We're going to buy all the businesses that we can without sacrificing our principals and our procedures for doing so. And right now that pipeline is full enough with businesses that give us the opportunity to make the decisions and feel pretty confident going through 2012.

MEL PAYNE: There is one thing, Clint, that's new, and it's dramatically different than anything we've done before, is that we did — we did launch at the end of November of last year what we called at the time a long-term value creation plan for our managing partners in the funeral homes; a little different on the cemetery side, so we haven't done anything like this there, but this is — this is to let them each have a five-year plan, and it really rewards organic growth in that business in that particular market. If they can achieve what we call a high level of standards over five years, they can get financially rewarded in a huge way, unlike any other company that's ever done this, and I think it will lead to more entrepreneurial talent coming to our company. It will allow us to bring talent into new businesses that Bill and his team buy. They're already good, but we want to grow them. And so if we can keep buying really good businesses and really good markets and have that kind of program that really lets people — not only just an annual basis, but a much longer basis — share in the value creation dynamic of their business, then I think it's a win/win/win for shareholders and for the company.

CLINT FENDLEY: Got it. Thanks, guys.

MEL PAYNE: You bet.

OPERATOR: Once again, if you would like to ask a question, please press star, then 1. Our next question comes from Duncan Brown of Wells Fargo Securities. Please go ahead.

DUNCAN BROWN: Hey, guys, good morning. I was wondering, Mel, if you could talk a little bit more about the rolling out of the long-term value creation plan and team member response to that, and then maybe if you're seeing any increased turnover from team members that either don't fit the bill or perhaps prefer the status quo.

MEL PAYNE: The response has been nothing short of incredible, something like this: "I cannot believe this company would do something like this for us." It's energized everybody. It's not easy. It's not easy, but the saying we have here in the company is, "Look, if it were easy, anybody could do it." This is not about being easy. This should be hard. Only the best can do it, and it means you've got to grow your business regardless of death rates, regardless of competition, demographics. You just have to find ways entrepreneurially to go find new market share in your community, and it's going to — it's attracting — it's energized the whole company. Are there a few around the company that say, "I don't think I can do that"? I haven't heard that. I'm sure there are, but the last time we injected something really new like this, which was around 2006, it doesn't take long to find out who the players are and who the people who can do it are, but I will tell you, I think we've got the best group of managing partners in the history of the company, and when you throw something like this into the mix, I mean, you kind of light a fire. The response has been almost immediate.

DUNCAN BROWN: Okay, great, appreciate those comments. It looks like you bought back roughly $700,000, a little more than that, of stock in the quarter, have a $5 million authorization. I'm just wondering if you could talk a little bit about your plans on that front in 2012 and then how you think about capital deployment of your free cash flow between preferences of M&A, dividends, and then stock repos.

WILLIAM HEILIGBRODT: On stock repurchase, we continue — we will continue to buy stock as long as we feel the stock price is under its intrinsic value and the value that we think it's worth as a company, up to the $5 million. So that's going to be continuing under those circumstances. We're aggressively trying to buy all the stock we can right now up to the $5 million.

DUNCAN BROWN: Okay.

MEL PAYNE: Bill didn't tell you what he thought the intrinsic value was, but it's nothing close to the current price.

DUNCAN BROWN: Fair enough. And then just one last one for me. I think you said in the press release you borrowed $2.5 million on the credit facility. Am I right that that's a revolver draw, and then I guess just your comfort level of using a revolver to fund or partially fund M&A going forward?

WILLIAM HEILIGBRODT: However, right now the revolver's just being used on a timing situation. As I mentioned last year, we virtually financed our total growth through free cash flow. I think that's a real point that probably we should look at. You know, I think our free cash flow I mentioned was up 21 percent last year, and when you look at that versus our stock price, that gets into that intrinsic calculation that Mel was talking about that we look at, and it's also — we have the opportunity, obviously, to run that on our own acquisition models, since we have a pretty detailed financial planning model to do that. So that's what we do. So we look at ourselves just like we would look at a company that we're buying. We should get a premium, we believe, so that's kind of how we come up with values as you look at it. So, obviously, the main component of that is cash flow.

DUNCAN BROWN: All right. Thanks, guys.

MEL PAYNE: Thank you.

OPERATOR: The next question comes from Alan Weber of Robotti and Co. Please go ahead.

ALAN WEBER: Good morning.

MEL PAYNE: Hey, Alan.

ALAN WEBER: Hi. A quick question or two. One is, you know, when you give — when you talked about in the projections for 2012, you know, it includes a few acquisitions that you made last year that should benefit the company this year, and you talked about some of the improvements. And yet the actual — the actual consolidated EBITDA is basically flat with what you showed as the non-GAAP consolidated EBITDA in 2011. Just curious as to why —

WILLIAM HEILIGBRODT: You're looking at GAAP versus non-GAAP, okay? The non-GAAP EBITDA is up considerably. It's $50 million, okay? So the GAAP EBITDA is different from the non-GAAP, so actually GAAP — GAAP and non-GAAP are going up.

MEL PAYNE: But to get the —

WILLIAM HEILIGBRODT: You have to compare the GAAP to get non-GAAP — you have to compare the GAAP EBITDA to GAAP EBITDA this year.

ALAN WEBER: Right, except isn't the non-GAAP EBITDA supposed to give an indication of what kind of, you know, kind of a going — you know, kind of not taking out the non-recurring items would be?

WILLIAM HEILIGBRODT: That's correct, but non-GAAP consolidated EBITDA grew from $46 million to $50 million this year, okay? And the number that's in the projection is non-GAAP — I mean, it's GAAP, excuse me, which would compare to $41 million last year.

ALAN WEBER: So what would you think would be the non-GAAP, which is — because you talked that the non-GAAP is the main — you know, is really the main part to focus on.

WILLIAM HEILIGBRODT: Well, non-GAAP EBITDA would be somewhere — let me look here; just a second — would be somewhere in the range of $55 [million] to $58 million versus $50 [million] this year.

ALAN WEBER: Okay, and then also — okay and then where the line has cash flow from operations —

WILLIAM HEILIGBRODT: Yes.

ALAN WEBER: — is basically flat or down from what you showed in 2011?

WILLIAM HEILIGBRODT: Yes, but it —

ALAN WEBER: What changes there?

WILLIAM HEILIGBRODT: In 2011 we had a special withdrawal from our trust funds that was around $10 million.

MEL PAYNE: Yeah, about $10.1 million.

WILLIAM HEILIGBRODT: $10.1 million, and that's not recurring. Some of that will recur but not all of it.

MEL PAYNE: It's hard to predict at this point, Alan, how much —

WILLIAM HEILIGBRODT: That will be.

MEL PAYNE: — that will be.

ALAN WEBER: Okay. And the next — my final question was it kind of was back to — from the previous question, you made the comment about you buy back stock, you look at the intrinsic value, and then did you say that you basically compare that to when you're looking at acquisitions prices?

WILLIAM HEILIGBRODT: Yes.

ALAN WEBER: And just what do you find?

WILLIAM

HEILIGBRODT: We find that we can — well, I mean, I'll just be quite [unintelligible]. We find that the — we don't find the same value relative to ourselves as we find relative to the acquisitions. Let me put it that way, okay?

ALAN WEBER: Okay, fair enough. Great. Thanks an awful lot.

MEL PAYNE: Thank you, Alan.

OPERATOR: As a reminder, if you would like to ask a question, please press star, then 1. Since there are no further questions, this concludes our question-and-answer session. I would like to turn the conference back over to management for closing remarks.

MEL PAYNE: Well, Bill and I appreciate everyone calling in, and those were great questions. I'd just like to say we hope you join us in our new beginning. We look forward to reporting the first quarter, and if you have any calls about anything in this press release or any other thing, it would be best to call Bill. He's heading up investor relations and is going to be talking about the company getting out in the country, so give him a call. He looks forward to hearing from you. Thank you very much.

OPERATOR: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.