

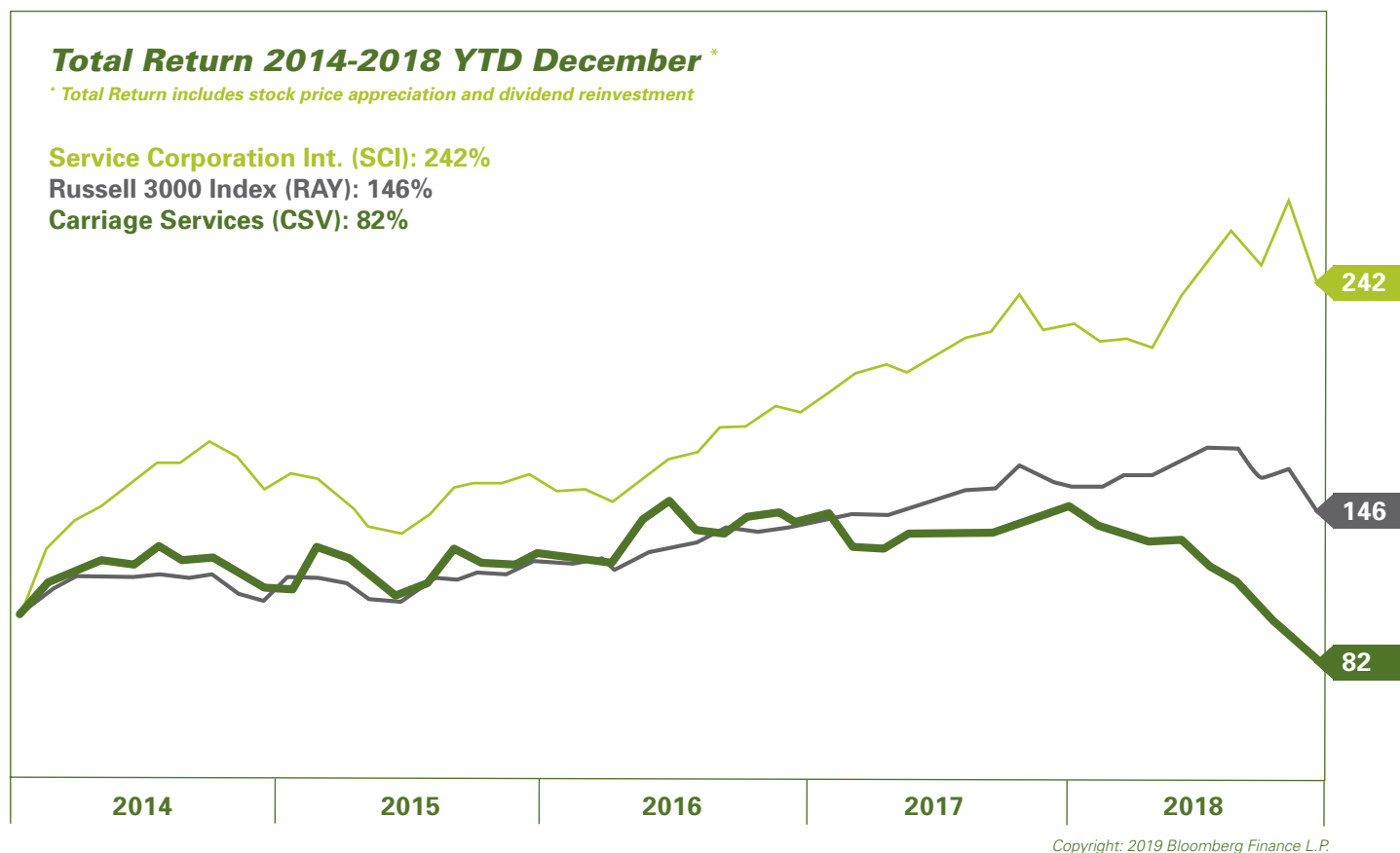
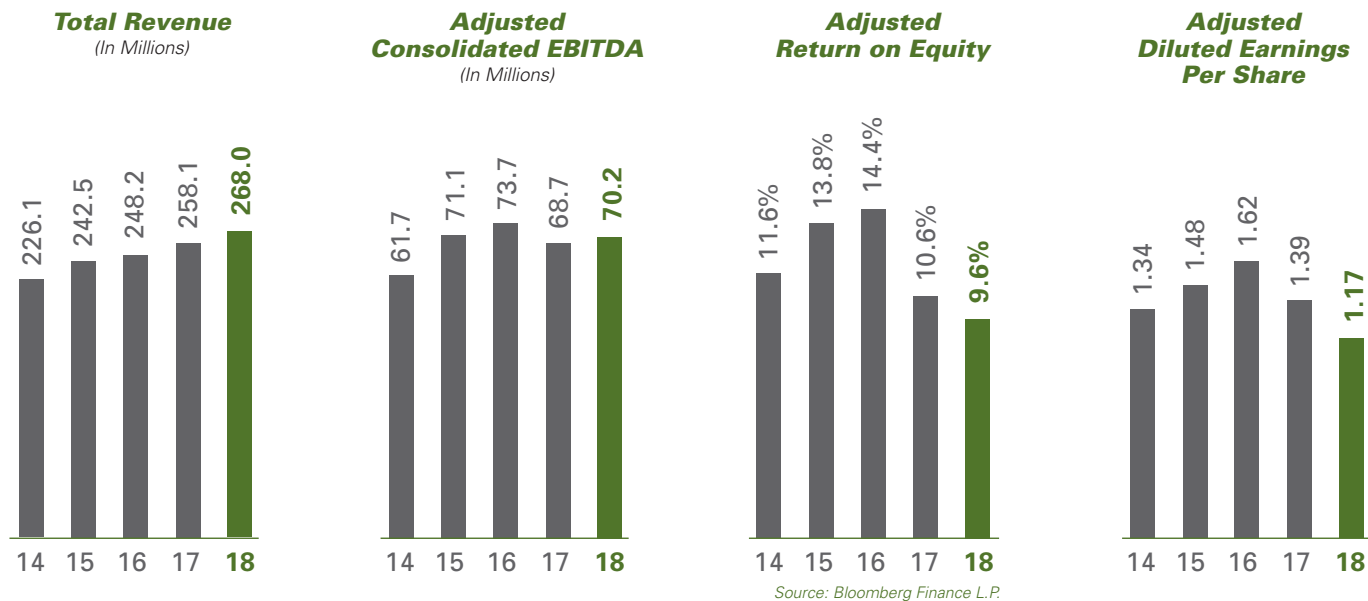


Never Give In!

A YEAR OF RENEWAL



2018
ANNUAL REPORT



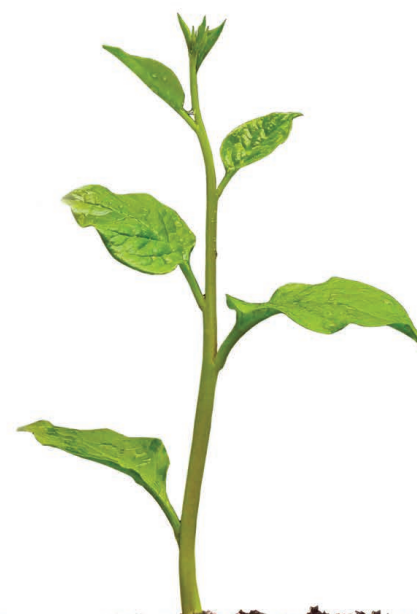
The Total Shareholder Return graph above reflects our relative performance comparing the five full years ending December 31, 2018 of Carriage (82%), SCI (242%) and the Russell 3000 Index (142%). Carriage's Total Shareholder Return since the beginning of 2014 has diminished as our stock price was \$19.53 per share on December 31, 2013, peaking at \$28.96 on April 25, 2018 before declining to \$15.50 per share on December 31, 2018.

SHAREHOLDER LETTER

I have been a long time student of Jim Collins and his wonderful books and research on “The Best of the Best” companies starting with *Built To Last* written with Jerry Porras in 1994. My favorite has been the “How To” build a great company perennial best seller *Good To Great* in 2001. We used the small number of *Good To Great* High Performance Concepts as reference and leadership mentoring material for building Carriage starting in 2012. We launched our first five year timeframe of Carriage’s *Good To Great Journey* that ended on December 31, 2016 with the annual theme of *Carriage Services 2012 – A NEW BEGINNING*, a five year timeframe during which Carriage’s share price increased at a compound annual rate of 38.6% from \$5.60 per share at January 1, 2012 to \$28.64 per share on December 31, 2016.

But this Shareholder Letter will not be about a *Carriage Good To Great Journey* that never ends, as we labeled it at the beginning of 2017. Jim published a subsequent book in 2009 titled *HOW THE MIGHTY FALL* with a subtitle, “And Why Some Companies Never Give In”, a subject matter that aptly describes what Carriage went through in 2018. The story of our performance decline that showed early symptoms in the second half of 2017 and accelerated in the second and third quarter of 2018 is regrettably captured by our share price peaking at \$28.96 on April 25, 2018 before collapsing 50% to a bottom of \$14.50 on December 24, 2018, ending the year with a closing price of \$15.50.

Jim wrote *How The Mighty Fall* because he was curious why some of “The Best of the Best” companies he had previously researched for *Built To Last* and *Good To Great* had fallen so far so fast, some tragically so by capitulation to irrelevance or even death. But as Jim’s research shows on why great companies fall, certain companies do indeed recover – in some cases coming back even stronger than before the decline. This Shareholder Letter will lay out clearly and with brutal honesty what happened to detour Carriage’s *Good To Great Journey* and how we rapidly responded with a passionate determination to **“NEVER GIVE IN!”**



I will start this Shareholder Letter with an email I received recently from Nicholas Welzenbach, one of our top Managing Partners whose name was recently submitted as a candidate to join our Standards Council. Nicholas explains better than I ever could in his own words the nature of what happened during 2017 and 2018 and why our determination to “NEVER GIVE IN” led to “A Year of Renewal” that should lead us back to our Good To Great Journey in 2019. We have therefore themed this year as Carriage Services 2019: Back To The Future – A NEW BEGINNING – PART II. We believe this second New Beginning for Carriage will produce much greater success in the future than ever achieved during any timeframe in the past.

From: Nicholas Welzenbach
Sent: Monday, February 25, 2019 10:22 AM
To: Mel Payne
Subject: Deepest Gratitude

Mel,

First and foremost, thank you for giving us our company back. This email is long overdue. I have written and re-written it so many times. Over the past few months, you have given Carriage Services the rebirth it was in need of. Your letters were raw, honest and to the point. There is not a day that goes by that I do not reference or review the letters you began sending in October. Serving as a Managing Partner for this wonderful company is an enormous honor, one I never take lightly.

Second, in February of this past year, I was in a dark place with Carriage Services and my future with our company. I had resigned myself to the understanding that I was no longer seen as a partner but more of just an employee. I read my letter to myself regularly to remain centered and keep focused. The gist of my letter; the most important things in the world to me are Kendall and our two wonderful children Audrey and Lachlan. I provide for my family by leading Darling & Fischer and Los Gatos Memorial Park to year over year success. How I feel about where I work needs to take a back seat. My family and our children’s future reign supreme.

I assure you, my passion for funeral service and caring for families never wavered. It was my place in a company I have dedicated myself to that had changed. I needed to search for other places for leadership and inspiration, as my resources in Houston had been stifled and the culture was disappearing. Your letters changed all of that overnight. The adage, “the pen is mightier than the sword” has never been more prevalent in my life. You are the leader we need right now and I know I speak for many of my constituents when I say, “Thank you!”

Being a funeral director and a nerd, I couldn’t be in a better place on earth. The Silicon Valley is full of individuals pushing limits and redefining people’s expectations. I have followed the life of Steve Jobs very closely. His goal was to make a dent in the universe, he most certainly did that. My goal is to make a dent in funeral service. I want to be a part of how our industry is perceived and experienced. I want to help redefine how our profession connects those that it serves.

This opportunity exists because of calculation and someone telling me no, when no, is not what I wanted to hear. Thank you for seeing the big picture when I was unable to. Thank you for your trust with these incredible businesses and allowing me to feel that I own them.

Mel, you and your company have created a place for passion and creativity for those that are willing to see opportunities for change and innovation. A million times over, thank you!

*Deepest Gratitude
Nicholas Welzenbach”*

Nicholas said in his third paragraph that “Your letters changed all of that overnight.” To understand what he meant, I will lay out in chronological sequence my memorandums and letters that comprehensively explain what happened to Carriage that produced a decline in our portfolio performance trends and what happened to “change all of that overnight.”

Memorandums to Managing Partners, Field Operations and Houston Support Center Leadership

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I. OCTOBER 1, 2018 MEMORANDUM: CARRIAGE GOOD TO GREAT TURNAROUND PLAN.

I am writing this letter to all of our field operations and support leadership to express my deep concern over declining performance trends in too many of our businesses in our funeral and cemetery portfolios over the last two years, but especially since the beginning of this year. Over the past month I have led a comprehensive analysis by our operating leadership and support teams of each of our businesses since 2011 using both operating and financial data trends as well as the corresponding Standards Achievement trends in each case.

I will clearly define the issues and challenges in this letter along with a comprehensive plan to turn around our total operating portfolio performance by year end 2018. The goal of this letter is not to blame or criticize anyone else for our current underperformance, as I am singularly and solely responsible. So it is now my responsibility and duty to you and all our employees, shareholders, bond holders, banks, suppliers and friends of the Carriage Family to restore the credibility of our **Being The Best Mission/Vision** in alignment with our **Five Guiding Principles**.

The profoundly important purpose of this letter is to rally and energize all of our field and support leaders around the idea of getting back on the **Carriage Good To Great Journey** with high and sustainable broad and deep portfolio performance beginning on January 1, 2019 and continuing through our second five year **Good To Great Journey** timeframe ending 2023. In order to set an excitedly determined tone for the comprehensive turnaround we will achieve together by year end 2018, I am also using this opportunity to communicate our annual theme for 2019:

Carriage Services 2019: Back To The Future – A NEW BEGINNING – PART II

Background History

Since co-founding Carriage over 27 years ago on June 1, 1991, there have been extreme internal and/or external circumstances at certain times when difficult decisions had to be made that were turning points which determined the future destiny of our company. One such turning point was at the end of 2011 when I realized that our senior leadership team and Board of Directors needed to be radically changed and restructured. This process was initiated on November 4, 2011 and continued over the first five year timeframe of **Carriage's Good To Great Journey** that never ends that began on January 1, 2012 with the theme **Carriage Services 2012 – A NEW BEGINNING**.

We are now at another such turning point related to our future destiny.

After completing the first five year timeframe of our **Good To Great Journey** in 2016, we entered a period in 2017 and thus far in 2018 that in hindsight has been a long transition during which too many businesses suffered from material declines in revenue and earnings. These declines regrettably offset the continued high performance success of our long term winners and even high quality new acquisitions. As I have stated many times in the past, if we are to **Be The Best** as a high performance culture company that just happens to be in the funeral and cemetery business, then we cannot tolerate our fabulous winning Managing Partners and teams of employees subsidizing the underperformers in our portfolio.

Good To Great Turnaround Plan

Since we have defined Carriage as a superior operating company among all funeral and cemetery business consolidators under the innovative framework of our funeral and cemetery Standards Operating Models, we must start with a goal related to high and sustainable Standards Achievement by every business in our portfolio.

A. 2018 Turnaround Plan Standards Achievement Goal:

Between October 2nd and November 30th we will implement action plans on a business by business basis with a goal of having each business in our portfolio over 50% Standards Achievement by December 31, 2018 and therefore positioned for High and Sustainable Standards Achievement success in 2019 and thereafter!

B. 2019 Standards Achievement Goals:

1. Funeral Portfolio – Total Standards Achievement of 65%:
 - Larger volume groupings (over 250 calls) with zero under 50% Minimum; and
 - Smaller Volume Groupings (under 250 calls) with 90% over Minimum.
2. Cemetery Portfolio – Total Standards Achievement as follows:
 - Ten largest – Total Standards Achievement of 75% with Zero Under Minimum; and
 - Smaller Grouping – Total Standards Achievement of 60% with 70% Over Minimum.

Update of Funeral Standards and Good To Great Award

Dealing with the changing preferences of client families in our industry and the revenue challenges from higher rates of cremations versus traditional burials is not an issue that has an easy solution. Yet many of our best Managing Partners and businesses have continued with High Standards Achievement in the face of these challenges as reflected by over 30 Pinnacle Award Winners each year.

As a central element of this **Good To Great** Turnaround Plan, we will update and reboot certain Funeral Standards in each of our four volume groupings as well as add a fifth volume grouping with annual calls over 600. In general these proposed changes, which will be presented to our Standards Council for approval by year end, will include lowering the current 2% growth rate standard for ARPC, raising the S&B Margin Ranges and lowering the EBITDAR Margin Ranges, particularly for our under 125 and 125-250 call groupings, thereby making sustained achievement of these two margin standards and ARPC growth more possible.

Our updated Standards Profitability Ranges (GM%, S&B%, EBITDAR%) will differentiate to a greater degree than in the past between volume groupings, recognizing the difficulty of sustaining high margins in a smaller business while simultaneously providing high value personal services to client families in a way that differentiates your business from competitors and leads to growth in market share.

A. Short and Long Term Goal of Funeral Standards Update:

The goal of the Funeral Standards update and case by case business turnaround plans is to enable every business to start out 2019 at 50% Standards Achievement or higher as follows:

STANDARD	WEIGHT	ACHIEVEMENT	COMMENTS
Volume	30%	?	Possible - too early to know
ARPC	15%	15%	Reboot at 12/31/18
GM%	10%	10%	Most already achieve
S&B%	12%	12%	Revenue and people cost adjustments
Bad Debt%	3%	3%	Most already achieve
EBITDAR%	10%	10%	Revenue and cost adjustments
Right Quality	10%	?	Possible
Continuous Upgrading	10%	?	Possible
TOTAL	100%	50%	Possible with upside on volume & staff

B. Goal of Funeral Operations:

Our historical goal has been to achieve compounded revenue growth in each business of 3% (roughly 1% volume and 2% ARPC), but we have fallen way short of this goal in most of our businesses because of secular revenue challenges and in too many cases market share losses from having the wrong leadership in place. The new goal of Funeral Operations is as follows: **Annual Revenue Growth of 1% to 2%.**

C. Funeral Good To Great Five Year Award Criteria Update: 2019 to 2023

1. **Good To Great Five Year Award** changed to now include all businesses that compound revenue over 1%.
2. **Good To Great Award Winners** in 1% to 2% compounded revenue growth group after five years receive a bonus (half cash / half stock) of 2 X Average Annual **Being The Best Standards Achievement Bonus**, while winners in the 2% to 3% growth and over 3% growth groups continue to receive 4 X and 6 X the Average Annual **Being The Best Standards Achievement Bonus**, respectively.
3. All **Good To Great Award Winning Managing Partners** now will receive an additional bonus pool to be allocated to employees for five year performance of the business.

Cemetery Portfolio Performance

We will also update and reboot certain Cemetery Standards in our Cemetery Standards Operating Model, thereby making sustained achievement of more cemetery standards possible.

Our portfolio combination funeral and cemetery and standalone cemetery businesses number 32 and represent about 25% of Carriage's total revenue. Historically our performance has been hugely dependent on our ten largest operations concentrated in California, Texas, Oklahoma, Louisiana and Florida. This year we have put in place high talented Sales Managers in each of these larger businesses along with substantial investment in new product inventory for sale. The timing of all of these "**Right Who**" Sales Manager moves could not have been better.

Conclusion

I have traditionally ended my annual theme letters to you with the profound research insight from the book **Good To Great** by *Jim Collins*:

***"Greatness is not a matter of circumstance.
Greatness, it turns out, is a matter of conscious choice!"***

I believe that each of you are here to make a high performance difference not only in your business but as an important team member of Carriage. I am therefore 100% confident that each of you will make "conscious and difficult choices" case by case as necessary in your business to get our **Good To Great Journey** back on track with high and sustainable performance as defined by **Being The Best Standards Achievement** during 2019.

II. OCTOBER 15, 2018 MEMORANDUM TO STANDARDS COUNCIL MEMBERS.

I want to thank each one of you for your recent thoughtful and serious feedback to Mike Loeffel who was calling on my behalf. I also want to apologize to all of you for my failure to get our operating leadership right. Some of you (you know who you are) have wrongly suffered from my failure to get it right and I will personally call at some point in the near future to apologize and ask for your forgiveness.

In the meantime, I am doing a complete review of our operating and corporate leadership organization and reporting, as well as brainstorming with OAPG on the update to our Funeral and Cemetery Standards Operating Models. I will chair the Standards Council update meeting in late November or early December during which we can discuss and debate the historical data and the Standards update recommendations in my letter and your individual feedback to Mike. I really like the revenue growth idea and moving away from ARPC! Keep THINKING UP GOODER IDEAS!! No more Standards Council “rubber stamp” B.S.!!

I will soon write a follow-up letter to all Managing Partners describing the leadership and reporting changes that are inevitable for a successful relaunch of our **Good To Great Journey – A NEW BEGINNING – PART II**.

III. OCTOBER 31, 2018 MEMORANDUM UPDATE ON CARRIAGE GOOD TO GREAT TURNAROUND PLAN – RENAMED “CARRIAGE HIGH PERFORMANCE AND VALUE CREATION TRENDS RESTORATION PROGRAM”.

On October 1st I wrote a letter to you expressing my deep concern over declining performance trends in too many of our businesses together with my initial thoughts and plans to get our portfolio of businesses performing again at a broadly higher level of Standards Achievement by January 1, 2019 and thereafter over the five year timeframe ending 2023. I also reached out confidentially for “brutally honest” feedback on the reasons for our portfolio performance decline, first to our Standards Council and subsequently to all of our Regional Partners and Directors of Support. Much like in a political election, “the votes are in and counted” and I am announcing in this letter to you the outcome and leadership and other changes necessary to get us back on the **Carriage Good To Great Journey** 100% aligned with our **Being The Best Vision**:

1. Vision for Carriage – Standards Operating Model / Decentralized Decision Making.

I have often defined “Leadership” as someone who has ideas about the present and a vision of the future that others want to align with and follow. Without strong follow-ship, there is no leadership.

Finding: The feedback expressed total support for the bottoms up ideas and decentralized decision making concepts related to our Standards Operating Model and Five Guiding Principles. Regrettably these ideas and concepts lost their alignment over the last two years with our **Being The Best Vision** and Guiding Principles.

Leadership Changes: Yesterday I assumed the role of Chief Operating Officer and Peggy Schappaugh the role of Interim Head of Operations Analysis and Planning Group.

Responsibility for Performance Declines: I take full and sole responsibility and am now once again fully engaged in operational leadership and ask for your help as we come together united as **One Team, One Vision** to get our company back on a **Good To Great Journey**.

2. **Being The Best Standards Council.**

Finding: Our Standards Operating Model only has credibility because of the “bottoms up” ideas from our Best Managing Partners that cause our decentralized concept of performance management to be superior to a top down “budget and control” model. We moved away from Carriage’s Vision of this concept over the last two years by treating our Standards Council (Best of our Best Managing Partners) as a rubber stamp for what Operational Leadership wanted them to do. Not Good!!

Changes: I will again become Chairman of the Standards Council and engage with our members more often during each year for their ideas and support. Without the PEER respect of what our Standards Council Members bring to all of us with their innovative ideas and proven success over many years, we are simply “talking the talk” rather than “walking the walk” and not listening and learning about how to get better. I will engage with our Standards Council related both to operating our individual businesses successfully over the long term as well as for ways of supporting our Managing Partners with systems and tools that make their achievement of standards success more likely and sustainable.

3. **Being The Best Standards Reboot / Update.**

Finding: Our Funeral and Cemetery Standards had become outdated and more difficult to achieve given the changing preferences of consumers and cremation trends over the last seven years since our last major revisions and update. In particular we focused on and weighted too heavily rigid standards like Average Revenue Per Funeral Contract and Preneed Cemetery Revenue Interment Average. We too often linked the inability to achieve these outdated metrics to also not achieving one or both of our two people standards, which had a demoralizing impact on many of our Managing Partners and their teams of employees. Even worse, concern over not achieving ARPC and/or people standards led in too many cases to Managing Partners not serving some low revenue cremation families (market share), an unintended consequence totally out of alignment with our First Guiding Principle.

Changes: I will chair a Standards Council meeting on Friday, November 30th during which we will discuss and debate a complete **reboot / update** of both our **Being The Best** Funeral and Cemetery Standards along with our annual **Being The Best** Standards Achievement Incentive Program to better align our definition of annual success with our Five Year **Good To Great** Awards tied to compound annual revenue growth.

The proposed changes outlined below are only thoughtful proposed ideas that mostly were derived from the feedback that was received from members of our Standards Council which address the underperformance trends in many of our businesses. The final updated Standards will be approved on November 30th by our Standards Council and then communicated and supported effective January 1, 2019.

Redefine **Being The Best** Standards Achievement Success:

- Decrease weighting on 3 year funeral volumes from 30% to 15% and transfer up to 30% - 35% weighting to different levels of compound annual revenue growth over 3 years, i.e. less weighting but still some on 0%-1% compound revenue growth, more on 1%-2%, even more on 2%-3% and maximum weighting over 3%, whereas any level of compound revenue decline would be weighted 0%.
- Either eliminate the Average Revenue Per Contract Standard entirely (and 2% annual growth in ARPC) or decrease the weighting from 15% to no more than 5%, transferring more weighting to compound annual revenue growth categories over 3 years (0%-1%, 1%-2%, 2%-3%, over 3%) so that a full 50% of Funeral Standards (and analogous Cemetery Standards) are related to compound annual revenue growth over 3 years, aligning perfectly with our Five Year **Good To Great** Incentive Program.
- Decrease the weightings of our two people standards to 5% each or a total of 10% and put the Right Quality and Continuous Upgrading people assessment standards back under the control of Managing Partners, Directors of Support and Regional Partners – supported with analytical data by employee from OAPG. We lost sight of the healthy FOREST (compound annual revenue growth) while HUGGING A TREE (ARPC) that often had dying limbs that were falling off but the tree was still relatively healthy!
- The individual business performance improvement plans being currently implemented across our portfolio are intended to get most of our underperforming businesses to at least 50% Standards Achievement using the existing standards format by December 31, 2018. The good news is that based on outstanding analytical work by Peggy, Shane, Brittney and Chris from their partnering with Directors of Support and Managing Partners, most of our businesses will be at a high level of Standards Achievement for 2019 using the proposed updated Standards format, meaning we should have a record number of Pinnacle Award Winners. That's more like it!
- Now the bad but absolutely necessary news. Any business below Minimum Standards of 50% using the rebooted / updated standards will be put into one of two subgroups. The first subgroup will consist of businesses that still have "franchise life and competitive standing" in their community worth an attempt to turn around, most likely under a new Managing Partner who didn't cause the destruction of business value but who very well could restore positive value creation trends related primarily to recapturing lost market share. For this group there will be more time flexibility and support relative to Standards Achievement, as an "injured business" takes time to lead back to stable health.

The second subgroup would be comprised of businesses that have suffered long term declines in market share and competitive standing and no longer contribute meaningfully to our portfolio performance. These would be divested and the capital we receive reinvested to achieve higher returns along with freeing up valuable time for our operational and support teams to focus elsewhere, thereby enabling others who need more attention to get better faster.

- We have not yet completed all the analysis and recommended changes to our Cemetery Standards, but they too will be thoughtful and intended to enable Managing Partners and Sales Managers and their teams to achieve broad and much higher and sustainable sales and operating performance in our cemetery portfolio, particularly our ten largest.

4. Leadership Roles and Responsibilities / Flat Organizational Structure.

Over the years since we introduced our Standards Operating Model at the beginning of 2004, the individual Standards evolved over time (until recently) so that they stayed relevant to changes in local market dynamics and client family preferences. Our corporate leadership organization also evolved along with defined roles and responsibilities, which over time resulted in a flat, more entrepreneurial and nimble organizational structure that was a “bottoms up” meritocracy as opposed to a “top down” layered bureaucracy. The idea and vision was that we turned the traditional hierarchy of operating and consolidating funeral home and cemetery businesses upside down and made the Managing Partner of each business the most important job in the company.

Finding: Over the last two years the “Power of the Right People” in our portfolio of businesses got recentralized in Houston and as an unfortunate result the designed leadership roles of our Regional Partners, Directors of Support, Operations Analysis and Planning Group Members and especially the “Senior Partner” role of our Managing Partners got confused and way out of alignment with our Standards Operating Model and Vision. We have also had way too much turnover in our Managing Partner ranks because many weren’t being successful at achieving outdated Standards. Not good, not acceptable and no longer.

Changes: I am actively engaging, coaching and mentoring all of our remaining operating leadership on the proper definition of their roles in support of the long term success of each Managing Partner and business. On **Thursday, November 29th** I will host a full day seminar for Regional Partners, Directors of Support, Operations Analysis and Planning Group and OSGLT Members on the proper definition and execution of their roles. All of these leaders will then participate in and/or observe the discussions and debate of our Standards Reboot / Update at our Standards Council Meeting on **Friday, November 30th**.

Finally, I will host all of these leaders on **Friday evening, November 30th** at a **Carriage One Team, One Vision Dinner** so that we have the month of December to communicate the revised **Being The Best** Standards and Standards Achievement Incentives effective **January 1, 2019**. Our goal is simple: To have a portfolio of businesses with **Being The Best** Standards Achievement Winning Managing Partners and employees. Only then can we become a **Good To Great Journey** company again.

5. Houston Support Center.

The idea of our Houston Support Center providing value added services to our Managing Partners (such as Legal, Accounting, Reporting, Human Resources, IT, Operations Analysis and Planning, etc.) that enable Managing Partners to more effectively focus locally on growing their market share and business by simply **Being The Best** at providing high value personal services through highly motivated and skilled teams of employees is a **Good To Great Concept**.

Finding: We have not kept current with our service offerings and support in several challenging areas such as more effectively dealing with cremation families and shoppers and the practical and effective use of social media to grow market share.

Changes: We will immediately explore ways in which we can develop support services and resource tools either internally or through third parties that can be made available to those Managing Partners and Sales Managers seeking help in handling cremation families and shoppers, using social media without being “tech geeky”, as well as in other areas where our support of you has become inadequate for you to successfully deal with the changing competitive dynamics in your market. We want more of you to become high performance winners so we have to do a much better job of supporting and that starts with better listening on our part. Please keep sending us your best ideas and suggestions for improved operating and back office support. Thanks in advance!

6. Monthly Reporting Format / Update Being The Best Standards.

Finding: Our monthly reporting for each business currently shows 4 full years and a rolling 12 months of operating data and income statement categories on the left side so that by December you can see five full years of trend data for your business. On the right side we show comparative rolling 3 months by month and year to date with the prior year so that you can easily determine whether you are achieving or trending close to achieving your standards, which are shown on the right. Obviously this reporting format was not increasing the number of Standards Achievement winners in our portfolio.

Changes: Each business will be reported in one of six compound revenue groupings (over 3%, 2%-3%, 1%-2%, 0%-1%, 0% to minus 3% and more than 3% decline), consistent with the proposed reboot / update of our Funeral and Cemetery Standards on November 30th to be effective January 1, 2019. The goal of operational and support leadership (Regional Partners, Directors of Support, Operations Analysis Planning Group, etc.) is to have more Managing Partners moving over time into higher compound annual revenue categories so that they and their winning teams of employees are increasingly recognized and rewarded as high performance heroes for the success in their respective businesses and communities.

7. Operational Leadership / Bottoms Up Staying in Touch.

Finding: Our operational leadership lost touch with what was going on in our businesses and resorted to “process and initiatives” that got no performance result but made it seem like they were always busy.

Changes: Our Regional Partners and Directors of Support, as well as our Operations Analysts, will spend more quality time selectively in our businesses (long enough to learn about the people and the market) so that our employees know we care about and are connected to their “real world” of challenges, support needs and opportunities to get better at the noble work we are privileged to do in their communities. We will also seek to find ways for some of our leaders including me to stay in touch other than through personal visits (sometimes distracting and intrusive if not sensitive to local schedule of activity). It is simply imperative that operating leadership stays in touch with the “beating people hearts” of our local businesses and to do everything possible to keep each business “big heart healthy”! Otherwise the “small brain” that exists in Houston only in service of each of our businesses will “die on the vine”.

We have cancelled the Annual Managing Partners / Sales Managers Meeting in Houston scheduled for June 2019 in order for us to get totally in touch with our Managing Partners and employees where they live and work in their respective local businesses and communities.

8. Operations and Strategic Growth Leadership Team – President and COO – CEO Successor.

At the beginning of 2017 I promoted a group of leaders to the senior leadership team (OSGLT) and thought that one or two members of this team might emerge as a CEO successor candidate over the next several years.

Finding: The Company needs stronger executive leadership that is completely aligned with the ideas and high performance concepts as defined by our three core models of Standards Operating, Strategic Acquisition and 4E Leadership, **Being The Best Vision** and Five Guiding Principles. We currently don't have an internal candidate to replace me as President and COO nor do we have a candidate to assume my role as CEO at some point in the future.

Change: I have assumed control of operations leadership and will also be announcing by year end a reorganization of the reporting structure of OSGLT Members and their roles and responsibilities. My intention is to lead operations through 2019 and the first half of 2020 but to begin an external search for a President and COO during the first half of 2020 and to have this new leader in place by the end of 2020.

To help me greatly improve my chances of selecting the **"Right Who"** on the President and COO search, I will form a Carriage Future Leadership Search Committee that will include at least two members of our Standards Council, two members of our Board of Directors, and two members of senior leadership. I look forward to that collaboration with a sense of purpose and great joy.

I am blessed that my health is outstanding even relative to much younger men, and my energy and passion for our people, our business and our company has never been greater. I intend to remain in my role as Chairman and CEO after finding the right President and COO and have no plans to retire as long as I am healthy and adding value to our company.

Summary

Shortly we will be releasing our Third Quarter Performance Earnings Release. I will be announcing some of what was in my October 1, 2018 Memorandum as well as the major leadership changes in this Memorandum. Some of you rightfully have worried about the current health and future outlook of our company as reflected in the decline in our share price from about \$28 per share in April to just under \$19 today. The reason I have taken bold leadership action to "get our high performance" back is because I have a fiduciary duty and loyalty to each of you and to the idea and **Being The Best Vision** of our company.

Do not worry about the stock price as our share price will follow the upward trend of our portfolio performance “turnaround” like night follows day. I have renamed the **Good To Great Turnaround Plan** (only for previous internal communication related to urgency and purpose) in our earnings release as follows:

High Performance and Value Creation Trends Restoration Program

We fully expect that as we measure and then communicate to public shareholders the performance success of all the changes I am announcing to you in this memorandum, our share price will take an upward trajectory much like it did when we launched the first five year timeframe of our **Good To Great Journey** on January 1, 2012. We ended 2011 at \$5.60 per share and increased fourfold into the low \$20’s per share by 2014. Since then we have been trading in a range of \$22 - \$28 per share, primarily in our view because of a convertible security we issued in 2014 that turned out to be a big mistake.

We recapitalized our balance sheet in May of this year, which mostly removed the convertible as a lid on our share price moving into the low \$30’s range. So the **ONLY** thing holding back our share price from taking its own **Good To Great Journey** upward and away is our portfolio performance and the perception by investors that our performance has been declining and leadership (me and you) doesn’t have a plan to reverse the declining trends.

My message to investors on our quarterly conference call tomorrow will be profoundly simple: **“Talk is cheap! So watch what we do!”** I have 100% confidence in the ideas and vision of our company and the leadership and employees who will now rise to the occasion and execute our updated Standards Operating Model at a high level of achievement to get our operating and financial performance back on a **Good To Great Journey** that will sustain itself through the five years ending 2023.

Our annual theme is therefore timely and profoundly appropriate:

Carriage Services 2019: Back To The Future – A NEW BEGINNING – PART II

As always, I leave you with this quote from the book **Good To Great** by *Jim Collins*:

***“Greatness is not a matter of circumstance.
Greatness, it turns out, is a matter of conscious choice!”***

The second Five Year Timeframe of our **Good To Great Journey** begins on January 1, 2019 and there is no place on earth that I would rather be than on this “what really matters” journey with each of you.

IV. NOVEMBER 6, 2018 MEMORANDUM TO CARRIAGE'S BOARD OF DIRECTORS.

The positive and inspiring feedback from the field continues to amaze even me. I would have thought it impossible to abuse the idea and vision of Carriage so fast that our Managing Partners, Directors of Support and Regional Partners became so demoralized with small thinking and top down authority that our high performance culture was literally smothered.

It shows again the brilliance of Jim Collin's simple and profoundly powerful insight, **First Who, Then What**. I picked the Wrong Who to lead operations and the What High Performance became Bad Low Performance in less than two years! Which also points to the upside opportunity now that Mr. Market fled CSV, but also the need to recruit a successor from outside the company (and likely the industry) that "Gets It" on Leadership out front with energy and passion.

I'm beginning to sense a bottoms up performance power infecting (in a good way) our leaders both in the field and home office. I think the **Carriage Good To Great Turnaround Plan** has quickly morphed into the **Carriage "Turn It Up" Transformation Plan!**

V. DECEMBER 3, 2018 MEMORANDUM: STANDARDS COUNCIL MEETING – BEING THE BEST 2019 FUNERAL STANDARDS.

On Thursday, November 29, 2018, I chaired a "Carriage University" meeting with almost fifty members of our Operating Leadership and Houston Support Center Teams including Regional Partners, Directors of Support, Operational Analysts, Accounting / Reporting, H.R., I.T., Treasury and Strategic Development. We spent the entire day redefining roles and responsibilities and reviewing the history and evolution of our Funeral and Cemetery Performance Standards and the various reboot / update options that would be considered by our Standards Council the following day.

On Friday, November 30, 2018, our Standards Council met all day (everyone from the prior day were observers) to discuss and debate various ideas and options to reboot and update our Funeral and Cemetery Performance Standards for 2019 and thereafter. I will briefly summarize the Funeral Standards that were approved, but before doing so I would like to take this opportunity to list the nine Managing Partners that currently serve on Carriage's Standards Council, eight of whom were present at the meeting. Steve Mora continues to recover from surgery a couple of weeks ago, but he is expected to be with us when we meet again during the month of February 2019 to approve 2018 Standards Achievement for each business.

Never have I been more proud and honored to be chairing a meeting of such High Performance Managing Partners who represent you and our company on our Standards Council. Kristi AhYou was recently added by way of "Battlefield Promotion" after she reached out to me with her ideas and help following my Memorandums of October 1, 2018 and October 31, 2018. And yes she was a rock star amongst all the other rock star Council Members on Friday.

NAME	BUSINESS	LOCATION	MEMBER SINCE
Kristi Ah You	Franklin & Downs	Modesto, CA	2018
James Bass	Emerald Cost/McLaughlin FH	Ft. Walton Beach, FL	2016
Mark Cooper	Seaside Memorial Park & FHs	Corpus Christi, TX	2009
Frank Forastiere	Forastiere Funeral Homes	Springfield, MA	2004
Kyle Incardona	Hillier Funeral Homes	Bryan/College Station, TX	2013
Justin Luyben	Evans Brown Mortuaries	Sun City, CA	2017
Steve Mora	Conejo Mountain FH & Memorial Park	Camarillo, CA	2013
Tom O'Brien	O'Brien Funeral Home	Bristol, CT	2017
James Terry	James Terry Funeral Homes	Downingtown, PA	2016

As a lead in to the new Funeral Standards (Cemetery Standards will be approved and communicated by the third week of December after Steve has recovered and can participate), I will offer a quote from a new Service and Guest Experience Standard presentation by Kyle Incardona on Friday, a presentation which was a **WOW** to everyone in attendance:

“To Be The Best and stay the best, we cannot become complacent. We must continue to be innovative and have the courage to change no matter how uncomfortable that change may be!”

After the enormous amount of positive and exciting feedback from the vast majority of our Managing Partners after my October 31, 2018 Memorandum, combined with the “brutally honest” feedback from our Standards Council Members, Directors of Support and Regional Partners after my October 1, 2018 Memorandum:

We listened to you, we heard you loud and clear, and we acted with boldness and speed to “redefine success” under the framework of our Standards Operating Model.

Shown on the next page is a table that includes the major changes that were made in our Funeral Standards, primarily relating to growth in Funeral Volumes and Revenue plus a new Service and Guest Experience Standard. The Volume (Market Share) and Revenue Standards are now weighted a combined 50% and the new Service and Guest Experience Standard 15%, totaling 65% for these three High Performance Funeral Standards. The new Service and Guest Experience Standard is expected over time to be a leading indicator of future market share and revenue growth and replaces our two previous People Standards that were weighted 10% each.

Any business with a three year compounded revenue decline will achieve 0% weighting whereas there are four potential three year compounded revenue growth categories of 0% to 1% (10% Achievement), 1 to 2% (25% Achievement), 2% to 3% (30% Achievement) and over 3% (35% Achievement). The Service and Guest Experience Standard will not be all or none and can range from 0% to 15%.

The variable and longer term growth structure of these new High Performance Standards will almost certainly make achieving 100% of our **Being The Best** Funeral Standards more difficult than in the past but should lead to more Managing Partners and their employee teams achieving over the Minimum Standard of 50% and being “in the money” for their annual **Being The Best** Incentive.

FUNERAL STANDARDS	EXISTING WEIGHTING %	NEW WEIGHTING %
Contract Volume (exceed 3-Year Average)	30%	15%
Average Revenue Per Contract (2% Annual Increase)	15%	Eliminate
Net Revenue (3-Year Compounded Growth) – NEW		
0% to <1%		10%
1% to <2%		25%
2% to <3%		30%
>3%		35%
Market Share/Revenue Growth Subtotal	Up to 45%	Up to 50%
Service and Guest Experience – NEW ⁽¹⁾		15%
Right Quality of Staff	10%	Eliminate
Continuous Upgrading of Staff	10%	Eliminate
People/Service Subtotal	Up to 20%	Up to 15%
Gross Margin % Range	10%	5%
S&B % Range	12%	10%
EBITDAR Margin % Range	10%	15%
Bad Debt % Range	3%	5%
Profitability Standards Subtotal	Up to 35%	Up to 35%
TOTAL FUNERAL STANDARDS	Up to 100%	Up to 100%

¹Kyle Incardona and Kristi AhYou are Co-Chairing Development of “measurement activities” by Managing Partners and Staff. This new “Game Changer” Service and Guest Experience Standard will incorporate and replace our People Standards.

The table above provides the detailed changes to the three “Top Line” High Performance Funeral Standards related to growth in Volume and Revenue plus a new Service and Guest Experience Standard. These three Standards together are weighted 65% of Total Funeral Standards, which reflects the dominant emphasis placed on long term growth in market share and revenue that are a result of high value funeral service experiences both for our client families and their guests.

The table on the next page provides the smaller yet still relevant changes to our four Funeral Financial Profitability Standards that total 35% of Total Funeral Standards. The table shows two of the four Funeral Home Groupings and related Financial Profitability Standards Matrix with four Adjusted Margin Ranges. The two Groupings not shown include one whose businesses have Average Revenue Per Contract (ARPC) of less than \$4,500 (higher cremation mix) and the other with ARPC of more than \$7,500 (more traditional burial mix).

Funeral Home Standards Group	Contracts <125 A	Contracts <125 - 250 B	Contracts <251 - 400 C	Contracts <401 - 600 D	Contracts <600 E	Contracts <125 A	Contracts <125 - 250 B	Contracts <251 - 400 C	Contracts <401 - 600 D	Contracts <600 E
ARPC Group	\$4,500 - \$6,000					\$6,001 - \$7,500				
Gross Margin Standard	86-88%	86-88%	86-88%	86-88%	86-88%	85-87%	85-87%	85-87%	86-88%	85-87%
Salaries & Benefits Standard*	30-32%	30-32%	27-29%	27-29%	27-29%	29-31%	27-29%	27-29%	27-29%	27-29%
Bad Debt Standard	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%
EBITDAR Standard	35-39%	37-41%	39-43%	40-44%	41-45%	36-40%	38-42%	40-44%	41-45%	42-46%

*For multiple location businesses (excludes dark chapels), add 1% to the S&B% ranges, for example if the S&B% range show 27-29%, for a multiple location business their range would be 28-30%.

In general the rebooted standards recognize and reward those Managing Partners who are able to grow the market share and revenue of their businesses at compounded rates of revenue growth with substantial differentiation between lower rates of revenue growth (0% to 1%) versus higher rates of revenue growth (maximum category over 3%). There has also been substantial relief on the S&B and EBITDAR Margin Ranges, especially for our smaller volume businesses. We have completely eliminated the Average Revenue Per Contract (ARPC) as well as our People Standards which were **DEAD ON ARRIVAL** at our Standards Council Meeting, so no one can be punished and demoralized with these Standards ever again.

As an innovative company, especially related to our unorthodox Standards Operating Model, we continue to listen, learn, adapt and evolve our High Performance Funeral and Cemetery Standards to keep them relevant to the changing trends and customer preferences in our businesses and markets. What is interesting is that we will now have 65% of our rebooted Funeral Standards and 65% of Cemetery Standards weighted directly and indirectly on long term (three year) compounded revenue growth and only 35% weighted on short term (one year) profit margins related to revenue.

The evolutionary history of our Standards Operating Model since 2003 is highly predictive about what will happen over the next five years: We will achieve higher same store rates of growth in revenue in both our funeral homes and cemeteries that will produce even higher compounded rates of growth in Field EBITDA because of the positive financial dynamics of operating leverage in our high fixed cost businesses.

Summary

As I will be traveling all week, I wanted to rush a summary of the 2019 Funeral Standards out to all our Managing Partners ASAP so that you can begin to have substantive discussions about the Standards Council Meeting and reasoning behind the changes that were made with our Regional Partners, Directors of Support, Analysts and Members of our Standards Council. I will write again with more color commentary in January, but will leave you with a handful of remarks that were made during the Standards Council Meeting and afterwards at a **One Team, One Vision** dinner on Friday night.

Energizing; Liberating; Freedom to Grow; Innovative; Out Of The Box Thinking; Radical Adaptation; Transformative; Leaning Into The Future; Game Changing!!

As you all know, our **Carriage Learning Journey** has had its ups and downs over time. Once in a while we must deal with existential crisis in our lives and business. I offer you a personal recent quote from Robert Maclary, Managing Partner of Kent Forest Lawn Funeral Home and Cemeteries in Panama City, Florida, which was recently devastated by Hurricane Michael (Robert and his team are operating out of a small sales office at Evergreen Cemetery and are temporarily working out of a portable trailer office as well).

“Seriously, the shock and awe is retreating. Funeral Homes had a great November and Cemetery Sales improved with more activity. We are back in the saddle, December will be great. Why, because we choose **GREATNESS! It’s who we are!**”

I’m inspired by Robert and his team and by all of you. What a way to jumpstart **Carriage Services 2019: Back To The Future - A NEW BEGINNING – PART III!**

VI. JANUARY 15, 2019 MEMORANDUM - CARRIAGE ANNUAL THEME LETTER.

Congratulations – we survived 2018 and have begun the second five year timeframe of Carriage’s **Good To Great Journey** that never ends with the annual theme for 2019:

Carriage Services 2019: Back To The Future – A NEW BEGINNING - PART II

For the many of you who were not a leader of or in an individual business, field operations or support center group on January 1, 2012 when we first launched Carriage’s **Good To Great Journey** with the annual theme, **A NEW BEGINNING**, the good news is that you are now in a leadership position that can determine whether Carriage quickly returns to a high and sustainable financial performance. In other words, you are once again the real owners of Carriage through your performance and therefore control the future destiny of our company.

Institutional investors who own most of our outstanding shares would in my view have a very difficult time understanding all that has happened underneath the “public covers” of Carriage over the last four months. However, what they do understand are the quarterly and annually reported performance trends of our portfolios of businesses starting in the first quarter of 2019 and thereafter which will directly impact our share price. And right now investor confidence in our future performance is very low, which is reflected in a share price of only \$16.86 at yesterday’s close of the stock market.

As soon as we show that our future performance will be back on an upward trend and that we have quickly reversed the negative trends of 2017 and especially 2018, then our share price will head north much like during the five year timeframe of 2012 – 2016. A little history will help provide a “big picture” perspective. We launched the first five year timeframe of Carriage’s **Good To Great Journey** after a previous significant management team restructuring and update of our Funeral Standards at the end of 2011, after which we achieved the following financial and Carriage (NYSE Symbol: CSV) share price results:

- Total Revenue increased at a compounded rate of 6.4% (Same Store and Acquisition) over the five years 2012 – 2016;
- Adjusted Consolidated EBITDA increased at a compounded rate of 10.8% over the five year timeframe;
- Adjusted Consolidated EBITDA Margin increased 5.5 percentage points over the five year timeframe to 29.7% in 2016 from 24.2% in 2011, a company and industry milestone never before reached by a consolidation company; and
- Carriage’s share price soared from \$5.60 per share at December 31, 2011 to \$28.64 on December 31, 2016, a compounded annual increase over five years of 38.6%.

After all the positive and exciting feedback that we have recently received from so many of you, I am 100% certain that **A NEW BEGINNING – PART II** will produce the same spectacular financial results and compounded share price increases over five years, except this time we begin with a base year share price of \$15.50 on December 31, 2018. So right now would be a great time for any of you not enrolled in our stock purchase program to do so, as I would much prefer to be celebrating with you five years from now rather than hearing, “Coulda, Woulda, Shoulda!”

First Who, Then What

The performance declines in our funeral and cemetery portfolios during 2017 and 2018 were made much worse by the operating leadership abuse of outdated Funeral and Cemetery Performance Standards, which had an increasingly demoralizing impact on our field leadership throughout the company during 2018 and led to a huge decline in our share price from a high of \$28.96 in April 2018 to a low of \$14.50 in December. The **Good To Great** concept of **First Who, Then What** works just as powerfully on the downside as the upside and explains our continuing focus on getting the leadership right at each business and throughout our field and support center teams.

We will continue our focus on **First Who, Then What** which means getting the Wrong People off the Carriage Bus and the Right People in the Right Seats on the Carriage Bus so that we never again experience the demoralizing impact and portfolio performance declines of the last two years. At this point it's time for our leadership at all levels to execute the recently rebooted and updated Funeral and Cemetery High Performance Standards, enabling us to once again drive the Carriage **Good To Great Journey** Bus toward **GREATNESS!**

Transformation: Mid-September through December 2018

I have been involved in many up and down cycles at Carriage since its founding on June 1, 1991. Most of the down cycles lasted years and seemed like they would never end. So what we have accomplished together over the last four months of 2018 has been nothing short of AMAZING, as summarized below:

1. October 1st Memorandum: Analytical Analysis and Profile of Portfolio Performance Declines since 2011.
2. October 31st Memorandum: Wrong People Off The Carriage Bus and diagnosis of outdated Funeral and Cemetery Performance Standards.
3. December 3rd Memorandum: Standards Council Approval of Rebooted / Updated Funeral Performance Standards.
4. December 21st Standards Council Telephonic Meeting: Approved Rebooted / Updated Cemetery Performance Standards.
5. December 3rd – January 8th: Collaboration by Carriage High Performance Team (Kyle Incardona, Kristi AhYou, Nathan Stiffler, Kyle Miller and many others) to create and roll out a Partnership Portal for the "Game Changing" new Funeral Service and Guest Experience Performance Standard.

I would like to thank all of the Managing Partners, Standards Council Members, Directors of Support, Regional Partners and Operations and Planning Group Analysts who let me know with brutal honesty how you had been demoralized during 2017 and 2018 and your thoughts about the rapid fire changes in leadership and Funeral and Cemetery Performance Standards over the last four months outlined above. Your feedback to me both directly through emails and indirectly through others has been the most energizing and inspiring experience of my long career.

So much so that I'm feeling twenty years younger and passionately excited about how our 4E Leadership Managing Partners and their **Being The Best** Employee Teams can increase our portfolio performance immediately ahead and thereafter over the second five year **Good To Great Journey** timeframe ending December 2023.

Standards Council Meeting / Service and Guest Experience Standard / Partnership Portal

Our Standards Council eliminated three Funeral Standards with a total weighting of 35% (ARPC weighted 15% and two People Standards weighted 10% each) and approved new Funeral and Cemetery Compounded Revenue Growth Standards plus the "Game Changer" Funeral Service and Guest Experience Standard weighted 15%. There has been a natural response from our Funeral Managing Partners that the new Service and Guest Experience Standard is to a large degree subjective and could be "abused" much like those that were eliminated at our Standards Council Meeting on November 30, 2018.

The Partnership Portal has been created to reduce the uncertainty and confusion that our Managing Partners might be feeling about how to measure "relative success" on this new standard weighted 15% (scale of 0 to 15%, not all or none).

- The Partnership Portal is a unique Carriage website built and designed to enable collaboration among Managing Partners and to learn from Managing Partners who are experiencing success;
- The Partnership Portal is a new tool for Managing Partners to both share and learn from Service and Guest Experience ideas, advice and best practices;
- The Partnership Portal will be used to highlight success stories related to the new standard, especially the "Guest Experience" element relating directly to future market share and higher compound rates of revenue growth over time;
- Our field leadership will be able to learn about upcoming events and program updates from the Carriage Digital Presence Team.

Anytime an innovation minded company like Carriage moves radically, boldly and swiftly to eliminate what doesn't work and to get out in front of the changing preferences of our client families (the ONLY THING we can be certain about is CHANGE!), then undoubtedly some people may find rapid change unsettling. The new Service and Guest Experience Standard as well as the Partnership Portal is a "work in progress" that will be continuously evolving and growing more relevant and effective for Managing Partners and your teams of employees as you provide both positive and negative feedback over time.

I want to especially thank Kyle Incardona and Kristi AhYou who both reached out to me during the recent management restructuring and Standards Reboot / Update transformative process wanting to help so that I could get Carriage and its senior leadership team aligned with our **Being The Best Mission / Vision and Five Guiding Principles**. The most successful companies getting the guest experience right also turn into companies that move from a **Good To Great Journey** to a **Built To Last** Company with a reputation for customer service second to none.

We have often described the noble work that is performed in our funeral homes and cemeteries for client families who have experienced or will experience in the future the death of a loved one as providing “high value personal services and sales.” Now we can broaden our focus to include all guests at all times and phases, as every “point of contact” is an opportunity for an experience that will leave a lasting impression that will enhance reputation and lead to increases in future market share which in turn leads to higher rates of compounded revenue growth.

A simple thing like unexpected random acts of kindness or courtesy to a non-client family “guest” can be what triggers loyalty to your business in the future. It’s all about the “mindset and motivation” of each employee and the ability of each Managing Partner to **ENERGIZE** their staff around this **Being The Best Vision** of the future.

I will pass on a bold prediction by Kyle Incardona when he first reached out to propose the adoption of the new Service and Guest Experience Standard as a replacement for the three that were eliminated: **“This new standard is a Carriage “Game Changer” and over time will attract better 4E Leadership and employee talent and lead to the best remaining independent businesses wanting to join Carriage.”** I can now also “boldly predict” that in five years Kyle will have proven to be a great predictor of the future success of Carriage.

Carriage Good To Great Journey Becoming A Built To Last Company

I have long been a “student learner” dedicated to the study of successful companies (**Good To Great** and **Built To Last** books by *Jim Collins* that profiled a handful of such companies) that were able to differentiate their long term financial and share price performance because of their enterprise mission, purpose, principles and high performance culture over long periods of time (20 to 50 years). I see no reason Carriage cannot rejoin the **Good To Great Journey** ranks and then become a **Built To Last** Company over the next ten years as each of you leads your performance higher and the **“Flywheel Effect”** literally sweeps across our portfolio and infects each of you with a “never-say-die, can do” attitude!

I have always been intrigued at how some individuals lead uniquely successful and meaningful lives and what causes them to do so. One of my favorite frameworks on successful individuals that I have shared with many of you in the past is published by Investors’ Business Daily (“**IBD**”), titled **IBD’s 10 Secrets To Success**, which I find timely and profoundly relevant as we launch **A NEW BEGINNING – PART II**.

Each one of you who leads one of our businesses and each one of us who is privileged to support your leadership can use **IBD’s 10 Secrets To Success** as a framework for thinking not only about our businesses and teams of employees but also about the joy and meaning our work and collaboration toward our **Being The Best Mission** and **Vision** provides to our personal lives. When we are bound together as **One Team** with **One Vision** of our businesses and personal lives, no degree of setback will be able to hold us back from continuing Carriage’s **Good To Great Journey** that never ends.

Setbacks Lead to Comebacks

I recently read a wonderful article in the Investors' Business Daily by Steve Watkins on ***Leaders and Success*** titled "***Problem Solving: Overcome Setbacks With A Comeback Attitude,***" and after our recent setbacks would like to share a few of the main points with you as we embark on **A NEW BEGINNING – PART II:**

- Setbacks are a fact of life. It's how you respond to and overcome setbacks that sets you apart from the crowd;
- People need an overarching reason to keep pushing when they hit a roadblock. That reason can't be monetary because it won't last. You have to attach a purpose that is emotional. Leaders must be connected to the purpose.
- Look for the lesson and learn from the setback. Turn your setbacks into comebacks.
- Realize that everyone, even those at the top, encounter setbacks. Life is 10% what happens to you and 90% how you respond.
- The power of a positive attitude can have an enormous impact on turning a setback into a comeback. Comebacks happen when you restore confidence and build momentum.
- Release your regrets while taking responsibility for your role in the setback. Regret only imprisons a person in self-pity.
- If you have people who aren't on board with the company's purpose and won't battle adversity, then get rid of them.

My unshakable belief is that the recent setbacks and our remarkable comeback over the last four months has positioned our company and each of you for unparalleled success over the next five years. Now let's show all the nay-sayers and doubters in our industry and world what a "**Carriage High Performance Culture Snapback Comeback**" really looks like!

Our annual theme is therefore timely and profoundly appropriate:

Carriage Services 2019: Back To The Future – A NEW BEGINNING – PART II

As always, I leave you with this quote from the book ***Good To Great*** by *Jim Collins*:

***"Greatness is not a matter of circumstance.
Greatness, it turns out, is a matter of conscious choice!"***

Like each of you I choose **Greatness** because that's just **WHO WE ARE!**

VII. FEBRUARY 12, 2019 MEMORANDUM: IMPORTANT ANNOUNCEMENTS.

We have now launched the second five year timeframe of **Carriage's Good To Great Journey** that never ends with the annual theme of **Carriage Services 2019: Back To The Future – A NEW BEGINNING – PART II**. From all the positive feedback that has been received from our Managing Partners, Directors of Support, Regional Partners and Operations & Acquisitions Analysis Group over the last five months, I believe we are now positioned for a long period of sustained success. Accordingly, I would like to share some important announcements with you.

Standards Council Members / Membership Goal, Criteria and Responsibility

Our Standards Council and each of its Members played a huge role with me and our leadership teams over the last five months as we went through a “brutally honest feedback process” of diagnosing and resolving the operating leadership issues and updating and rebooting our High Performance Funeral and Cemetery Standards. The Council Members and I are in full agreement on the important role they must have within Carriage in the future if we are to prove to those outside of Carriage that the idea and concept of a decentralized decision making business model (Standards Operating Model) that is relevant, well executed and supported is a superior and indeed unique model for operating and consolidating Funeral Home and Cemetery businesses.

I am honored to once again list below the nine members of our Standards Council. We developed a one page draft description (still a work in progress with Standards Council Members) for review at our recent Standards Council Meeting that defines the Standards Council Membership Goal as well as Membership Criteria and Responsibility. Once these membership matters have been completed and approved, we will post the final description on our website.

NAME	BUSINESS	LOCATION	MEMBER SINCE
Kristi Ah You	Franklin & Downs	Modesto, CA	2018
James Bass	Emerald Cost/McLaughlin FH	Ft. Walton Beach, FL	2016
Mark Cooper	Seaside Memorial Park & FHs	Corpus Christi, TX	2009
Frank Forastiere	Forastiere Funeral Homes	Springfield, MA	2004
Kyle Incardona	Hillier Funeral Homes	Bryan/College Station, TX	2013
Justin Luyben	Evans Brown Mortuaries	Sun City, CA	2017
Steve Mora	Conejo Mountain FH & Memorial Park	Camarillo, CA	2013
Tom O'Brien	O'Brien Funeral Home	Bristol, CT	2017
James Terry	James Terry Funeral Homes	Downingtown, PA	2016

Please feel free to contact any one of our Council Members for help, as they have a long and successful history as **Being The Best** Managing Partners. We are also in the process of pulling together personal biographies on each Council Member and posting them to the new Service and Guest Experience Portal so that you can see what areas (Service and Guest Experience, Social Media, etc.) each Member views as a strength.

Senior Leadership Team Reorganization

There have been many changes related to field operations over the last five months, including me assuming the role of Chief Operating Officer. I am also pleased to announce a major change in the organizational structure of the Houston Support Center Senior Leadership Team.

I have formed a new six member Carriage Executive Team on which I serve as Chairman and is also comprised of Viki Blinderman, Senior Vice President, Principal Financial Officer and Chief Accounting Officer; Ben Brink, Senior Vice President, Chief Financial Officer and Treasurer; Shawn Phillips, Senior Vice President and Head of Strategic and Corporate Development – who has also stepped back into operations as Regional Partner of the Central Region; Michael Loeffel, Vice President of Human Resources; and Steve Metzger, Senior Vice President and General Counsel. As part of this reorganization I am pleased to announce that Steve Metzger has been promoted to Senior Vice President and General Counsel and will head Carriage’s legal team.

Other members of our Senior Leadership Team will continue to report to me including operations leadership comprised of our three Senior Vice Presidents and Regional Partners, Shawn Phillips, Paul Elliott, and Chris Manceaux; and Peggy Schappaugh, Director of Operations & Acquisition Analysis. I am disbanding the former Operations and Strategic Growth Leadership Team (OSGLT) as we now have the 4L Leadership Team (Listening, Learning, Loving and Leading) comprised of a broader and deeper group of aligned leaders in our Houston Support Center.

Over the last several months the 4L Leadership Team along with all Directors of Support have gone through an extensive course curriculum (Carriage University) relating to learning about the idea / concept and evolution of our Standards Operating Model. This group of over forty leaders attended as observers at the Standards Council Meetings on November 30th (approved updated / rebooted Funeral Standards) and February 7th (approved Standards Achievement for each Managing Partner and business for 2018). There was no final exam for this group of 4L Leaders because the “Learning Journey” about Carriage and its high performance culture ideas and concepts will never end!

It also gives me great pleasure to announce that Peggy Schappaugh has been promoted to Director of Operations & Acquisitions Analysis (the name of the group has changed to reflect their new responsibility for acquisitions). Peggy’s Operations & Acquisitions Analysis Group (OAAG) will now assume the responsibility of vetting all acquisition candidates that are submitted by Corporate Development with updated Strategic Acquisition Criteria that are in alignment with our updated and rebooted High Performance Funeral and Cemetery Standards.

Additionally, Members of the Operations & Acquisitions Analysis Group, which consists of Shane Hinds, Brittney Riddick and Chris Cooper, have had their titles changed from Analyst to Senior Operations and Acquisitions Partner to more accurately reflect their actual duties. In addition to their existing responsibilities they will incorporate analysis of historical operational and financial data trends for each acquisition candidate and development of a five year and ten year operational and financial forecast used for valuation of the business.

And last but certainly not least, I am pleased and proud to announce that Winnie Hurston with over twelve years in the trenches as my foxhole buddy (occasionally being hit by friendly fire) facilitating our **Being The Best Vision** and **Carriage's Good To Great Learning Journey**, has earned a title change to Senior Executive Assistant to CEO and Special Projects Manager. But while the new title is the official one, my unofficial title will always be **Winnie The Winner** and **CEO Force Multiplier!**

Summary

Our goal from all the major changes over the last five months is to substantially improve the operating and financial performance trends of our existing portfolio of businesses while adding new businesses by acquisition to our existing portfolio that have a higher revenue growth profile. Once new acquisitions are integrated into our Standards Operating Model Framework, the new Managing Partner and employee team will be able to achieve a high level (70% or higher) of our updated Funeral and/or Cemetery Standards. Carriage will then become a magnet for the best talent and independent businesses in our industry and well on our way toward the long term goal of moving from being a **Good To Great Company** to a **Built To Last Company**.

But first we must **EXECUTE** the recently updated and rebooted High Performance Standards at a **VERY HIGH ACHIEVEMENT Level** consistent with **Carriage Services 2019: Back To The Future – A NEW BEGINNING – PART II!**

As always, I leave you with this quote from the book *Good To Great* by *Jim Collins*:

***“Greatness is not a matter of circumstance.
Greatness, it turns out, is a matter of conscious choice!”***

I choose **GREATNESS** because I want to get back on the **Good To Great Journey** with you!

VIII. CONCLUSION TO SHAREHOLDER LETTER.

The last four months of 2018 and first two months of 2019 have been the most humbling experience in my long business career, a sentiment that is not related to the problems we experienced but to the wonderful feedback which I received from so many of our Managing Partners, Directors of Support, Regional Partners, Operations and Acquisition Analysis Partners and 4L Team Members all during this period of renewal. Their expressions of support, commitment and collaboration on new ideas for continuous improvement have been inspiring and energizing not only to me but to all the other field and support team leaders and employees as well as to the Members of our Board of Directors.

I started this Shareholder Letter with a long and wonderful recent email from Nicholas Welzenbach, Managing Partner of one of our large funeral home and cemetery businesses in San Jose that have been part of our portfolio since 1998. I will end this Shareholder Letter with one of the earliest and the shortest but just as wonderfully profound email from Victor LoGiudice, a new Managing Partner of a large and fabulous funeral home business on Long Island that joined Carriage in late 2017. I received Victor's email one day after my October 31, 2018 Memorandum announcing our "**NEVER GIVE IN**" Findings and "**A Year of Renewal**" Changes.

"From: Victor LoGiudice
Sent: Thursday, November 1, 2018 3:15 PM
To: Mel Payne
Subject: Update on Carriage Good To Great Turnaround Plan

Dear Mel,
Thank you. I wish I could express in words what your memo meant to me, but unfortunately I am at a loss.

Sincerely,

Victor J. LoGiudice, CFSP
Managing Partner"

Much like Victor, I am at a loss to find words sufficient to express my gratitude, respect for and thanks to each of the many Managing Partners whose personal feedback to me either directly or indirectly at the time was like food for the heart, mind and soul. However, I do find the highest and most principled honor in dedicating this Shareholder Letter to all of the Managing Partners of our operating businesses and especially to those special nine "Foxhole Partners" who serve on our Standards Council.

Respectfully,



Melvin C. Payne
Chairman and Chief Executive Officer

CARRIAGE 2018 GOOD TO GREAT AWARD – HIGH PERFORMANCE HEROES

At the beginning of 2012 we created a new five year incentive award with the name **Good To Great Award** that was directly linked to our annual **Being The Best Pinnacle Award** which itself is linked to High Funeral Standards Achievement over a full year, i.e. our **Good To Great Awards** require high and sustained **Being The Best** Standards Achievement over a full five years. We have had many wonderful performances since the start of our **Good To Great Journey** by High Performance Hero Funeral and Cemetery Managing Partners and Sales Managers and their teams of winning employees. So I am more than honored on behalf of our Standards Council Members, senior leadership team and Board of Directors to announce our third group of **Good To Great Award** winners for the five year timeframe that began in 2014 and ended at year end 2018, who are listed below.

Sue Keenan
Matthew Simpson
Mike Conner
Curtis Ottinger
Ben Friberg

Byron Keenan Funeral Home & Cremation; Springfield, MA
Fry Memorial Chapel; Tracy, CA
Conner Westbury Funeral Home; Griffin, GA
Heritage Funeral Home; Chattanooga, TN
Heritage Funeral Home and Crematory; Fort Oglethorpe, GA

CARRIAGE 2018 PINNACLE OF SERVICE AWARD WINNERS – HIGH PERFORMANCE HEROES

As an important part of our **High Performance Culture** tradition and language, and because we have a passionate conviction that **RECOGNITION** is the highest form of motivation, listed below are 34 Carriage Managing Partners who were **“Being The Best” Pinnacle Of Service Award** winners and 8 Managing Partners who achieved **100% Of Standards** for 2018.

“Being The Best” Pinnacle Of Service Award

Jeff Seaman	Dwayne R. Spence Funeral Homes; Canal Winchester, OH
Justin Luyben	Evans-Brown Mortuaries & Crematory; Sun City, CA
Jeff Hardwick	Bryan & Hardwick Funeral Home; Zanesville, OH
Andy Shemwell	Maddux-Fuqua-Hinton Funeral Homes; Hopkinsville, KY
James Bass	Emerald Coast/McLaughlin Mortuary; Fort Walton Beach, FL
*Steven Mora	Conejo Mountain Funeral Home; Conejo Mountain Memorial Park; Camarillo, CA
Brian Binion	Steen Funeral Homes; Ashland, KY
Curtis Ottinger	Heritage Funeral Home; Chattanooga, TN
Sue Keenan	Byron Keenan Funeral Home & Cremation; Springfield, MA
Alan Kerrick	Dakan Funeral Chapel; Caldwell, ID
Bob Prindiville	Bright Funeral Home & Cremation Service; Wake Forest, NC
Mike Conner	Conner-Westbury Funeral Home; Griffin, GA
Ashley Vella	Deegan Funeral Chapels; Escalon, CA
Kim Borselli	Fuller Funeral Home-Cremation Service (Pine Ridge); Naples, FL
Brad Shemwell	Latham Funeral Home; Elkton, KY
Kyle Incardona	Hillier Funeral Homes; Bryan / College Station, TX
John Fitzpatrick	Donohue & Cecere Funeral Homes; Westbury, NY
James Terry	James J. Terry Funeral Home; Downingtown, PA
Bob Pollard	Lotz Funeral Home-Salem; Salem, VA
Wayne Lovelace	Lotz Funeral Home-Vinton; Vinton, VA
Todd Muller	All Cremation Options; Naples, FL
Verdo Werre	McNary-Moore Funeral Service; Colusa, CA
Bill Martinez	Stanfill Funeral Home; Miami, FL
Jason Cox	Lane Funeral Home-South Crest; Rossville, GA
Roger Allen	LaGrone-Blackburn-Shaw Funeral Homes; Amarillo, TX
Dan Simons	Everly Community Funeral Care; Falls Church, VA
Robert Maclary	Kent-Forest Lawn Funeral Home; Panama City, FL
*Nicholas Welzenbach	Darling Fischer Funeral Homes; Los Gatos, CA

“Being The Best” Pinnacle Of Service Award & 100% of Standards Award

*Nicholas Welzenbach	Los Gatos Memorial Park; Los Gatos, CA
Ken Summers	P.L. Fry & Son Funeral Home; Manteca, CA
Matthew Simpson	Fry Memorial Chapel; Tracy, CA
Courtney Charvet	North Brevard Funeral Home; Titusville, FL
Jeff Steadman	Sansone Funeral Home; Bristol, RI
Patrick Schoen	Jacob Schoen & Son; New Orleans, LA
*Tim Hauck	Harvey-Engelhardt/Fuller Metz; Fort Myers, FL

“Being The Best” 100% Of Standards Award

*Tim Hauck	Lee County Cremation Services; Fort Myers, FL
Cyndi Hoots	Schmidt Funeral Homes; Katy, TX

* Qualified for 2 Businesses

HIGH PERFORMANCE CULTURE FRAMEWORK



ANNUAL OPERATING AND FINANCIAL TREND REPORT

This table uses Non-GAAP financial measures to present the financial performance of the Company. Non-GAAP financial measures should be viewed in addition to, and not as an alternative for, the Company's reported operating results or cash flow from operations or any other measure of performance as determined in accordance with GAAP. We believe the Non-GAAP results are useful to investors because such results help investors compare our results to previous periods and provide insights into underlying trends in our business. In addition, the Company's presentation of these measures may not be comparable to similarly titled measures in other companies' reports. The Non-GAAP financial measures include "Funeral, Cemetery and Financial EBITDA", "Total Field EBITDA", "Total Field EBITDA Margin", "Divested Revenue", "Divested EBITDA", "Divested EBITDA Margin", "Consolidated EBITDA", "Adjusted Consolidated EBITDA", "Adjusted Consolidated EBITDA Margin", "Adjusted Net Income", "Adjusted Basic Earnings Per Share", "Adjusted Diluted Earnings Per Share" and "Special Items". A full copy of our Annual Operating and Financial Trend Report and reconciliations of the Non-GAAP financial measures to GAAP measures are provided on our website, www.carrigeservices.com.

(in thousands, except per share amounts)	2014	2015	2016	2017	2018	CAGR
Same Store Contracts						
Atneed Contracts	23,914	23,899	23,572	24,393	24,422	
Preneed Contracts	5,768	5,881	5,693	5,769	5,666	
Total Same Store Funeral Contracts	29,682	29,780	29,265	30,162	30,088	0.3%
Acquisition Contracts						
Atneed Contracts	995	1,845	2,774	3,993	5,931	
Preneed Contracts	288	425	460	687	797	
Total Acquisition Funeral Contracts	1,223	2,270	3,234	4,680	6,728	
Total Funeral Contracts	30,905	32,050	32,499	34,842	36,816	4.5%
Funeral Operating Revenue						
Same Store Revenue	\$ 155,041	\$ 159,511	\$ 157,759	\$ 161,690	\$ 160,459	0.9%
Acquisition Revenue	6,926	14,523	20,636	30,108	41,447	
Total Funeral Operating Revenue	\$ 161,967	\$ 174,034	\$ 178,395	\$ 191,798	\$ 201,906	5.7%
Cemetery Operating Revenue						
Same Store Revenue	\$ 37,777	\$ 39,083	\$ 40,678	\$ 40,047	\$ 41,740	2.5%
Acquisition Revenue	1,298	2,995	3,053	3,195	3,395	
Total Cemetery Operating Revenue	\$ 39,075	\$ 42,078	\$ 43,731	\$ 43,242	\$ 45,135	3.7%
Total Financial Revenue	\$ 17,933	\$ 18,403	\$ 17,558	\$ 16,320	\$ 16,239	-2.5%
Total Divested Revenue	\$ 7,149	\$ 7,987	\$ 8,516	\$ 6,779	\$ 4,712	-9.9%
Total Revenue	\$ 226,124	\$ 242,502	\$ 248,200	\$ 258,139	\$ 267,992	4.3%
Field EBITDA						
Same Store Funeral Field EBITDA	\$ 56,871	\$ 61,049	\$ 61,512	\$ 62,361	\$ 58,976	0.9%
Same Store Funeral Field EBITDA Margin	36.7%	38.3%	39.0%	38.6%	36.8%	
Acquisition Funeral Field EBITDA	2,657	6,370	8,643	11,770	15,397	
Acquisition Funeral Field EBITDA Margin	38.4%	43.9%	41.9%	39.1%	37.1%	
Total Funeral Field EBITDA	\$ 59,528	\$ 67,419	\$ 70,155	\$ 74,131	\$ 74,373	5.7%
Total Funeral Field EBITDA Margin	36.8%	38.7%	39.3%	38.7%	36.8%	
Same Store Cemetery Field EBITDA	\$ 11,613	\$ 13,586	\$ 13,878	\$ 12,368	\$ 12,733	2.3%
Same Store Cemetery Field EBITDA Margin	30.7%	34.8%	34.1%	30.9%	30.5%	
Acquired Cemetery Field EBITDA	340	1,099	1,049	1,039	1,147	
Acquired Cemetery Field EBITDA Margin	26.3%	36.7%	34.4%	32.5%	33.8%	
Total Cemetery Field EBITDA	\$ 11,953	\$ 14,685	\$ 14,927	\$ 13,406	\$ 13,880	3.8%
Total Cemetery Field EBITDA Margin	30.6%	34.9%	34.1%	31.0%	30.8%	
Total Financial EBITDA	\$ 16,594	\$ 17,016	\$ 16,412	\$ 14,998	\$ 14,687	-3.0%
Total Financial EBITDA Margin	92.5%	92.5%	93.5%	91.9%	90.4%	
Total Divested EBITDA	\$ 2,284	\$ 2,419	\$ 2,919	\$ 1,977	\$ 1,373	-11.9%
Total Divested EBITDA Margin	31.9%	30.3%	34.3%	29.2%	29.1%	
Total Field EBITDA	\$ 90,359	\$ 101,539	\$ 104,413	\$ 104,512	\$ 104,313	3.7%
Total Field EBITDA Margin	40.0%	41.9%	42.1%	40.5%	38.9%	
Total Overhead	\$ 34,127	\$ 34,667	\$ 35,898	\$ 36,430	\$ 36,993	2.0%
Overhead as a percentage of Revenue	15.1%	14.3%	14.5%	14.1%	13.8%	
Consolidated EBITDA	\$ 56,232	\$ 66,872	\$ 68,515	\$ 68,082	\$ 67,320	4.6%
Consolidated EBITDA Margin	24.9%	27.6%	27.6%	26.4%	25.1%	
Other Expenses and Interest						
Depreciation & Amortization	\$ 11,923	\$ 13,780	\$ 15,421	\$ 15,979	\$ 17,430	
Non-Cash Stock Compensation	3,832	4,444	2,890	3,162	6,583	
Interest Expense	10,308	10,559	11,738	12,948	21,109	
Accretion of Discount on Convert. Sub. Notes	2,452	3,454	3,870	4,329	2,192	
Loss on Early Extinguishment of Debt	1,042	-	567	-	502	
Loss on Redemption of Convert. Jr. Sub. Deb.	3,779	-	-	-	-	
Other, Net	195	45	1,788	(1,118)	1,238	
Pretax Income	\$ 22,701	\$ 34,590	\$ 32,241	\$ 32,782	\$ 18,266	-5.3%
Net Tax Provision	7,255	13,737	12,660	(4,411)	6,621	
GAAP Net Income	\$ 15,446	\$ 20,853	\$ 19,581	\$ 37,193	\$ 11,645	-6.8%
Total Special Items, Net of tax	\$ 9,348	\$ 6,508	\$ 8,757	\$ (12,444)	\$ 9,921	
Adjusted Net Income	\$ 24,794	\$ 27,361	\$ 28,338	\$ 24,749	\$ 21,566	-3.4%
Adjusted Net Profit Margin	11.0%	11.3%	11.4%	9.6%	8.0%	
Reconciliation of Consolidated EBITDA to Adjusted Consolidated EBITDA						
Consolidated EBITDA	\$ 56,232	\$ 66,872	\$ 68,515	\$ 68,082	\$ 67,320	4.6%
Total Special Items	\$ 5,421	\$ 4,261	\$ 5,176	\$ 620	\$ 2,872	
Adjusted Consolidated EBITDA	\$ 61,653	\$ 71,133	\$ 73,691	\$ 68,702	\$ 70,192	3.3%
Adjusted Consolidated EBITDA Margin	27.3%	29.3%	29.7%	26.6%	26.2%	
GAAP Diluted EPS	\$ 0.83	\$ 1.12	\$ 1.12	\$ 2.09	\$ 0.63	-6.7%
Adjusted Diluted EPS	\$ 1.34	\$ 1.48	\$ 1.62	\$ 1.39	\$ 1.17	-3.3%
Average Number of Diluted Shares Outstanding	18,257	18,313	17,460	17,715	18,374	0.2%
GAAP Basic EPS	\$ 0.84	\$ 1.16	\$ 1.18	\$ 2.25	\$ 0.64	-6.6%
Adjusted Basic EPS	\$ 1.35	\$ 1.52	\$ 1.71	\$ 1.50	\$ 1.19	-3.1%
Average Number of Basic Shares Outstanding	18,108	17,791	16,515	16,438	17,971	-0.2%

Carriage Services

2018 FORM 10-K



**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the year ended, December 31, 2018

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number: 1-11961

CARRIAGE SERVICES, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

76-0423828
(I.R.S. Employer
Identification No.)

3040 Post Oak Blvd., Suite 300, Houston, Texas
(Address of principal executive offices)

77056
(Zip Code)

Registrant's telephone number, including area code: (713) 332-8400
Securities registered pursuant to Section 12(b) of the Act:

(Title of each class)
Common Stock, \$.01 Par Value

(Name of each exchange on which registered)
New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Securities Exchange Act of 1934.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Securities Exchange Act of 1934. Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 29, 2018 was approximately \$434.5 million based on the closing price of \$24.55 per share on the New York Stock Exchange.

The number of shares of the registrant's Common Stock, \$.01 par value per share, outstanding as of February 22, 2019 was 18,183,198.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its 2019 annual meeting of stockholders, which will be filed with the Securities and Exchange Commission within 120 days of December 31, 2018, are incorporated in Part III of this Annual Report on Form 10-K.

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CAUTIONARY NOTE

Certain statements and information in this Annual Report on Form 10-K (this “Form 10-K”) may constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical information, should be deemed to be forward-looking statements. The words “may,” “will,” “estimate,” “believe,” “expect,” “anticipate,” “plan,” “intend,” “foresee,” “should,” “would,” “could” or other similar expressions are intended to identify forward-looking statements, which are generally not historical in nature. These forward-looking statements include, but are not limited to, statements regarding any projections of earnings, revenue, asset sales, cash flow, debt levels or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements regarding future economic and market conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing and are based on our current expectations and beliefs concerning future developments and their potential effect on us. While management believes that these forward-looking statements are reasonable as and when made, there can be no assurance that future developments affecting us will be those that we anticipate. All comments concerning our expectations for future revenue and operating results are based on our forecasts for our existing operations and do not include the potential impact of any future acquisitions. Our forward-looking statements involve significant risks and uncertainties (some of which are beyond our control) and assumptions that could cause actual results to differ materially from our historical experience and our present expectations or projections. Important factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to, those summarized below:

- our ability to find and retain skilled personnel;
- our ability to execute our growth strategy;
- the execution of our Standards Operating, 4E Leadership and Standard Acquisition Models;
- the effects of competition;
- changes in the number of deaths in our markets;
- changes in consumer preferences;
- our ability to generate preneed sales;
- the investment performance of our funeral and cemetery trust funds;
- fluctuations in interest rates;
- our ability to obtain debt or equity financing on satisfactory terms to fund additional acquisitions, expansion projects, working capital requirements and the repayment or refinancing of indebtedness;
- the timely and full payment of death benefits related to preneed funeral contracts funded through life insurance contracts;
- the financial condition of third-party insurance companies that fund our preneed funeral contracts;
- increased or unanticipated costs, such as insurance or taxes;
- our level of indebtedness and the cash required to service our indebtedness;
- changes in federal income tax laws and regulations and the implementation and interpretation of these laws and regulations by the Internal Revenue Service;
- effects of the application of other applicable laws and regulations, including changes in such regulations or the interpretation thereof;
- consolidation of the funeral and cemetery industry; and
- other factors and uncertainties inherent in the funeral and cemetery industry.

For additional information regarding known material factors that could cause our actual results to differ from our projected results, please see Part I, Item 1A, Risk Factors.

Investors are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statements after the date they are made, whether as a result of new information, future events or otherwise.

PART I

ITEM 1. BUSINESS.

GENERAL

Carriage Services, Inc. (“Carriage,” the “Company,” “we,” “us,” or “our”) was incorporated in the State of Delaware in December 1993 and is a leading provider of funeral and cemetery services and merchandise in the United States. We operate in two business segments: funeral home operations, which currently accounts for approximately 80% of our total revenue, and cemetery operations, which currently accounts for approximately 20% of our total revenue.

At December 31, 2018, we operated 182 funeral homes in 29 states and 29 cemeteries in 11 states. We compete with other publicly held funeral and cemetery companies and smaller, independent operators. We believe we are a market leader in most of our markets.

Our funeral homes offer a complete range of high value personal services to meet a family’s funeral needs, including consultation, the removal and preparation of remains, the sale of caskets and related funeral merchandise, the use of funeral home facilities for visitation and remembrance services and transportation services. Our cemeteries provide interment rights (grave sites and mausoleum spaces) and related merchandise, such as markers and outer burial containers. We provide funeral and cemetery services and products on both an “atneed” (time of death) and “preneed” (planned prior to death) basis.

CURRENT YEAR DEVELOPMENTS

Acquisitions. During 2018, we acquired four funeral home businesses. On July 10, 2018, we acquired two funeral home businesses, one in Fredericksburg, Virginia and one in Stafford, Virginia. On August 21, 2018, we acquired a funeral home business in Cookeville, Tennessee and on August 28, 2018, we acquired a funeral home business in Knightdale, North Carolina. The pro forma impact of the acquisitions on prior periods is not presented as the impact is not material to our reported results. The results of the acquired businesses are included in our results of operations from the date of acquisition.

Executive Leadership Changes. On October 29, 2018, Mark R. Bruce informed us that he would resign from his position as Executive Vice President and Chief Operating Officer effective November 1, 2018.

Share Repurchase Program. During the year ended December 31, 2018, we repurchased 1,101,969 shares of common stock for a total cost of approximately \$17.7 million at an average cost of \$16.03 per share pursuant to our share repurchase program. Based on all repurchases to the date of this Current Report on Form 10-K, we have approximately \$8.3 million available for repurchase under our approved program.

Performance-Based Stock Awards. On November 29, 2018, we cancelled all the Performance Award Agreements previously awarded to all individuals in 2016, 2017 and 2018, which resulted in a write-off of \$3.3 million. Prior to such cancellation, each of the cancelled Performance Award Agreements provided for contingent compensation, which was payable to the recipients of the awards in shares of common stock, based on our performance over a five-year period from the date of grant.

Dividends. During 2018, we paid \$5.5 million in dividends.

Balance Sheet Recapitalization. On April 25, 2018, we entered into an eighth amendment to our former secured credit facility, which increased the aggregate revolving credit commitment available thereunder to \$200.0 million.

On May 7, 2018, we completed privately-negotiated exchanges of approximately \$115.0 million in aggregate principal amount of our 2.75% Convertible Subordinated Notes due 2021 (the “Convertible Notes”) for \$75.2 million in cash and 2,822,859 newly issued shares of our common stock.

On May 31, 2018, we completed the issuance of \$325.0 million in aggregate principal amount of 6.625% Senior Notes due 2026 (the “Senior Notes”). We used \$291.4 million of the net proceeds from the sale of the Senior Notes to repay all amounts outstanding under our former secured credit facility and all commitments thereunder were terminated.

On May 31, 2018, in connection with the issuance of the Senior Notes, we entered into a new \$150.0 million senior secured revolving credit facility (the “New Credit Facility”).

On December 24, 2018, we completed privately-negotiated repurchases of an additional \$22.4 million in aggregate principal amount of Convertible Notes for \$23.0 million in cash, leaving a principal balance of \$6.3 million outstanding as of December 31, 2018.

CARRIAGE GOOD TO GREAT JOURNEY

Over the latter part of 2018, We embarked on a rapid and transformative High Performance and Value Creation Trends Restoration Program. We performed a comprehensive analysis of each of our businesses since 2011 using both operating and financial data trends as well as the corresponding Standards Achievement trends. Our goal was to first identify the root causes of the declining performance trends over the last two years in too many of our portfolio businesses and then to quickly make the necessary changes to restore positive performance trends beginning in the first quarter of 2019 and continuing thereafter for a five year timeframe ending in 2023. We believe we have rallied and energized all of our field and support leaders around the idea of getting back on the Carriage **Good To Great Journey** with high and sustainable broad and deep portfolio performance.

The changing preferences of client families in our industry and the revenue challenges from higher rates of cremations versus traditional burials are not issues that have easy solutions. Yet many of our best Managing Partners and businesses have continued with High Standards Achievement in the face of these challenges. As a central element of this High Performance and Value Creation Trends Restoration Program, we have done the following:

- solicited feedback on the reasons for our portfolio performance decline, first from our Standards Council and subsequently from all of our Regional Partners and Directors of Support;
- Mel Payne, our Chief Executive Officer, has directed more of his time and attention to operations and is actively engaging, coaching and mentoring all of our remaining operating leadership on the proper definition of their roles in support of the long-term success of each Managing Partner and business;
- updated and rebooted our Funeral and Cemetery Standards as well as the groupings that we utilize to review our businesses to ensure alignment with changing preferences of client families and our High Performance and Value Creation Trends Restoration Program;
- redefined Standards Achievement success and updated criteria for the **Being The Best** and **Good To Great** incentive programs; and
- continued to explore ways in which we can develop support services and resource tools, either internally or through third parties, that can be made available to our Managing Partners and Sales Managers. We expect that this support focus, on areas such as social media, will better prepare our field leaders to deal with the changing competitive dynamics in each market.

FUNERAL AND CEMETERY INDUSTRY

Funeral home and cemetery businesses provide products and services to families in three principal areas: (i) ceremony and tribute, generally in the form of a funeral or memorial service; (ii) disposition of remains, either through burial or cremation; and (iii) memorialization, generally through monuments, markers or inscriptions.

The funeral and cemetery industry in the United States is characterized by the following fundamental attributes (the industry statistics and information included in this Form 10-K are from reports compiled by Sundale Research based on information as of September 30, 2018 from the U.S. Department of Commerce).

Deaths and Death Trends

During 2018, the number of deaths in the United States increased by approximately 1.4% following a 2.1% and a 1.2% increase in 2017 and 2016, respectively. The rapidly growing and aging population is expected to result in an increase in the number of deaths in the future. The number of Americans age 55 to 64 totaled 42.0 million in 2017 and is expected to grow 1.9% to 46.2 million by 2022, making this the second fastest-growing age group, while the fastest-growing segment of the population is Americans aged 65 and older, with 49.6 million in 2017. This age group is expected to increase to 57.3 million in 2022, reflecting an average annual growth rate of 2.9%. Overall, from 2017 to 2022, the number of deaths in the United States is expected to increase by an average of 1.8% per year, reaching an estimated 3.1 million in 2022.

Burial and Cremation Trends

While the number of deaths is expected to increase over the next few years, the burial rate is expected to continue to decline. In 2018, the number of burials in the United States decreased by an estimated 2.5%, following declines of 0.9% and 1.8% in 2017 and 2016 respectively. The number of burials in the United States is estimated to fall by an average of 1.0% per year from 2017 through 2022. In 2022, it is estimated that there will be approximately 1.29 million burials in the United States and a burial rate of 42.0%.

In 2018, the number of cremations in the United States increased by an estimated 5.0%, following increases of 5.1% and 4.3% in 2017 and 2016, respectively. Slower growth is expected through 2022, due in part to the sheer size of the market for cremations; however, shifting preferences will continue to lead to a considerable rise in cremations. The number of cremations in the United States is expected to grow by an average of 4.2% per year from 2017 through 2022. In 2022, it is estimated that there will be approximately 1.78 million cremations in the United States and a cremation rate of 58.0%.

Highly Fragmented Ownership

Our industry remains highly fragmented, and succession planning issues for privately-owned funeral and cemetery businesses have become more difficult and complex than ever. We believe Carriage provides a unique consolidation and operating framework that offers a highly attractive succession planning solution for owners who want their legacy family business to remain operationally prosperous in their local communities. We also believe that our decentralized operating model will continue to attract the top entrepreneurial talent in our industry. Our focus is on partnering with the best of the remaining independent funeral home and cemetery owners in major strategic markets around the country where the potential for future revenue growth is the highest.

The largest publicly held operators, in terms of revenue, of both funeral homes and cemeteries in the United States are Service Corporation International (“SCI”), StoneMor Partners L.P. (“StoneMor”) and Carriage. We believe these three companies collectively represent approximately 20% of funeral and cemetery revenue in the United States. Independent businesses, along with a few privately-owned consolidators, represent the remaining amount of industry revenue, accounting for an estimated 80% share of revenue.

Heritage and Tradition

Funeral home and cemetery businesses have traditionally been family-owned businesses that have built a local heritage and tradition through successive generations, providing a foundation for ongoing business opportunities from established client family relationships and related referrals. Given the sensitive nature of our business, we believe that relationships fostered at the local level build trust in the community and are a key driver of market share. While new entrants may enter any given market, the time and resources required to develop local heritage and tradition serve as important barriers to entry.

BUSINESS STRATEGY

Our business strategy is based on strong, local leadership with entrepreneurial principles that is focused on sustainable long term market share, revenue, and profitability growth in each local business. We believe Carriage has the most innovative operating model in the funeral and cemetery industry, which we are able to achieve through a decentralized, high-performance culture operating framework linked with incentive compensation programs that attract top-quality industry talent to our organization.

Our **Mission Statement** states that “we are committed to being the most professional, ethical and highest quality funeral and cemetery service organization in our industry” and our **Guiding Principles** state our core values, which are comprised of:

- Honesty, integrity and quality in all that we do;
- Hard work, pride of accomplishment and shared success through employee ownership;
- Belief in the power of people through individual initiative and teamwork;
- Outstanding service and profitability go hand-in-hand; and
- Growth of the Company is driven by decentralization and partnership.

Our five **Guiding Principles** collectively embody our **Being The Best** high-performance cultural, operating framework. Our operations and business strategy are built upon the execution of the following three models:

- Standards Operating Model;
- 4E Leadership Model; and
- Strategic Acquisition Model.

Standards Operating Model

Our Standards Operating Model is focused on growing local market share, people development, and the key operating and financial metrics that drive long-term, sustainable revenue growth and improved earning power of our portfolio of businesses by employing leadership and entrepreneurial principles that fit the nature of our high-value personal service business. Standards Achievement is the measure by which we judge the success of each business and incentivize our local managers and their teams. Our Standards Operating Model is not designed to produce maximum short-term earnings because we believe such performance is unsustainable and will ultimately stress the business, which very often leads to declining market share, revenue and earnings.

Important elements of our Standards Operating Model include:

- *Balanced Operating Model* – We believe a decentralized structure works best in the funeral and cemetery industry. Successful execution of our Standards Operating Model is highly dependent on strong local leadership, intelligent risk taking, entrepreneurial drive and corporate support aligned with the key drivers of a successful operation organized around three primary areas - market share, people and operating financial metrics.
- *Incentives Aligned with Standards* – Empowering local managers, who we call Managing Partners, to do the right things in their operations and local communities, and providing appropriate support with operating and financial practices, will enable long-term growth and sustainable profitability. Each Managing Partner participates in a variable bonus plan whereby he or she earns a percentage of his or her respective business' earnings based upon the actual standards achieved as long as the performance exceeds our minimum standards. Our five year incentive award, called the “**Good to Great Award**,” rewards Managing Partners with a bonus at the end of five years, equal to a ratio of four to six times their average annual bonus, if they are able to achieve an annual compound growth rate of 2% over a five year period. After each five year incentive plan is achieved and paid out, a new five year plan period begins. To date, we have had three performance periods in which we have paid \$3.8 million to the Managing Partners who have earned a bonus under this program.
- *The Right Local Leadership* – Successful execution of our operating model is highly dependent on strong local leadership as defined by our 4E Leadership Model, intelligent risk taking and entrepreneurial empowerment. A Managing Partner's performance is judged according to achievement of the standards for that business.

4E Leadership Model

Our 4E Leadership Model requires strong local leadership in each business to grow an entrepreneurial, decentralized, high-value, personal service and sales business at sustainable profit margins. Our 4E Leadership Model is based upon principles established by Jack Welch during his tenure at General Electric, and is based upon 4E qualities essential to succeed in a high-performance culture: *Energy* to get the job done; the ability to *Energize* others; the *Edge* necessary to make difficult decisions; and the ability to *Execute* and produce results. To achieve a high level within our Standards in a business year after year, we require local Managing Partners that have the 4E Leadership skills to entrepreneurially grow the business by hiring, training and developing highly motivated and productive local teams.

Strategic Acquisition Model

Our Standards Operating Model led to the development of our Strategic Acquisition Model, which guides our acquisition strategy. We believe that both models, when executed effectively, will drive long-term, sustainable increases in market share, revenue, earnings and cash flow. We believe a primary driver of higher revenue and profits in the future will be the execution of our Strategic Acquisition Model using strategic ranking criteria to assess acquisition candidates. As we execute this strategy over time, we expect to acquire larger, higher margin strategic businesses.

We have learned that the long-term growth or decline of a local branded funeral and cemetery business is reflected by several criteria that correlate strongly with five to ten year performance in volumes (market share), revenue and sustainable field-level earnings before interest, taxes, depreciation and amortization (“EBITDA”) margins (a non-GAAP measure). We use the following criteria, to name a few, to rank the strategic position of each potential acquisition:

- cultural alignment;
- volume and price trends;
- size of business;
- size of market;
- competitive standing;
- demographics;
- strength of brand; and
- barriers to entry.

The valuation of the acquisition candidate is then determined through the application of an appropriate after-tax cash return on investment that exceeds our cost of capital.

Our belief in our **Mission Statement** and **Guiding Principles** that define us and proper execution of the three models that define our strategy have given us the competitive advantage in any market in which we compete. We believe that we can execute our three models without proportionate incremental investment in our consolidation platform infrastructure and without additional

fixed regional and corporate overhead. This gives us a competitive advantage that is evidenced by the sustained earning power of our portfolio as defined by our EBITDA margin.

Other elements of our overall business strategy include the following:

Enhancement of Funeral and Cremation Services. Personalization and pre-planning continue to be two of the most important trends in the funeral and cremation services and merchandise industry, but the move toward more cremations may be the most significant. While this trend is expected to continue, other factors are expected to lead to rising industry revenue, including an increase in spending on additional or unique funeral and cremation services.

The percentage of funeral services performed by our funeral homes for which cremation was chosen was 50.7% for the year ended December 31, 2016, 51.4% for the year ended December 31, 2017 and 52.2% for the year ended December 31, 2018. Shifting preferences will likely continue to lead to a considerable rise in cremations; as such, we are focused on educating and providing our cremation customers additional services and products that are available. All of our funeral homes offer cremation products and services. While the average revenue for a cremation service is generally lower than that of an average traditional, full-service funeral, we have found that this revenue can be substantially enhanced by our emphasis on offering additional services and merchandise, including counseling referrals, video tributes, flowers, burial garments and memorial items such as urns, keepsake jewelry and other items that hold a portion of the cremated remains.

Preneed Funeral Sales Program. We operate under a local, decentralized preneed sales strategy whereby each business location customizes its preneed program to its local needs. Approximately 20% of our funeral services performed are funded through preneed contracts, which are usually secured by placing the funds collected in trust for the benefit of the customer or by the purchase of a life insurance policy, the proceeds of which will pay for such services at the time of need. Insurance-funded contracts allow us to earn commission income to improve our near-term cash flow and offset a significant amount of the up-front costs associated with preneed sales. Trust funded contracts typically provide cash that is invested in various securities with the expectation that returns will exceed the growth factor in the insurance contracts. The cash flow and earnings from insurance contracts are more stable, but are generally lower than traditional trust fund investments. In markets that depend on preneed sales for market share, we supplement the arrangements written by funeral directors with sales sourced by sales counselors and third party sellers.

Preneed Cemetery Sales Program. Our preneed cemetery strategy is to build family heritage in our cemeteries by selling property and internment rights prior to death through full time, highly motivated and entrepreneurial local sales teams. Approximately 40% of our cemetery operating revenue is derived from preneed property sales. Our goal is to build broader and deeper teams of sales leaders and counselors in our larger and more strategically located cemeteries in order to focus on growth of our preneed property sales. Cemetery merchandise and services are often purchased in addition to cemetery property at the time of sale. The performance of these preneed cemetery contracts is secured by placing the funds collected in trust for the benefit of the customer, the proceeds of which will pay for such services at the time of need. General consumer confidence and discretionary income have a significant impact on our preneed sales success rate.

OUR STRENGTHS

Market Leader. We compete with other public funeral and cemetery companies and smaller, independent operators and believe we are a market leader in most of our markets. We focus on markets that perform better than the industry average and are generally insulated from material economic and demographic changes.

High Performance, Decentralized, Partnership Culture. Our funeral homes and cemeteries are managed by Managing Partners with extensive funeral and cemetery industry experience, often within their local markets. Our Managing Partners have responsibility for day-to-day operations, but are required to follow operating and financial standards based on our Standards Operating Model that are custom designed for distinct business groupings which is based on the size (number of funerals) and average revenue per funeral. This strategy allows each local business to maintain its unique identity within its local market and to capitalize on its reputation and heritage while our senior leadership provides support services from our corporate headquarters in Houston, Texas. We believe our culture is very attractive to owners of premier independent businesses that fit our profile of suitable acquisition candidates.

Flexible Capital Structure. We have no short-term debt maturity issues. We believe that our capital structure provides us with financial flexibility by allowing us to invest our cash flow in growth opportunities, such as business acquisitions and cemetery inventory projects. For additional information regarding our capital structure, please see Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, Liquidity and Capital Resources.

Stable Cash Flow. We have demonstrated the ability to generate strong and stable cash flow. Cash flow from operations for 2018 totaled \$49.0 million, which was used primarily for the acquisition of four funeral home businesses, capital expenditures and our working capital needs, including payment of dividends and our debt obligations. We intend to use our cash flow to acquire

funeral home and cemetery businesses and to fund internal growth projects, such as cemetery inventory development and funeral home expansion projects, and for payment of dividends and our debt obligations. Our growth strategy is the primary way we expect to increase stockholder value. We may also use available cash flow to repurchase shares of our common stock and remaining convertible notes from time to time. While we reassess our capital allocation strategy annually, we currently believe that our financial goals will best be achieved by continuing to improve the operating and financial performance of our existing portfolio of businesses while selectively investing our net cash flow in growth opportunities that generate a return on invested capital in excess of our weighted average cost of capital.

Strong Field-Level Gross Profit Margins. We believe that we have strong field-level gross profit margins and that this performance is a testament to the success of our business strategies. Our strong margins and the ability to control costs are important advantages in a business such as ours that is characterized by a high fixed-cost structure. We will continue to seek ways to improve our financial performance, and we believe that our Standards Operating Model will continue to yield long-term improvement in our financial results.

Integrated Information Systems. We have implemented information systems to support local business decisions and to monitor performance of our businesses compared to financial and performance standards. All of our funeral homes and cemeteries are connected to our Houston support home office, which allows us to monitor and assess critical operating and financial data and analyze the performance of individual locations on a timely basis. Furthermore, our information system infrastructure provides senior management with a critical tool for monitoring and adhering to our established internal controls, which is critical given our decentralized model and the sensitive nature of our business operations.

Proven Leadership Team. Our leadership team, headed by our founder, Chairman and Chief Executive Officer, Melvin C. Payne, is characterized by a dynamic culture that focuses on addressing changing market conditions and emerging trends in the funeral services industry. We believe our culture of emphasizing the 4Es (Energy, Energize Others, Edge and Execution) leadership characteristics is critical and will provide an important advantage as the funeral and cemetery industry evolves. We are committed to continue operating an efficient organization and strengthening our corporate and local business leadership. Our businesses are supported by a broader team of High Performance leaders across multiple disciplines located in our Houston home office. This promotes more cooperation and synergy between our funeral and cemetery operations and supports the goal of market-share and volume growth in our most significant markets.

OUR OPERATIONS

We conduct our funeral and cemetery operations only in the United States. Our operations are reported in two segments: funeral home operations and cemetery operations. Information for each of our segments is presented below and in our financial statements set forth herein.

Funeral Home Operations

At December 31, 2018, we operated 182 funeral homes in 29 states. Funeral home revenue currently accounts for approximately 80% of our total revenue. The funeral home operations are managed by a team of experienced industry professionals and regional leadership with substantial management experience in our industry. See Part II, Item 8, Financial Statements and Supplementary Data, Note 22 for segment data related to our funeral home operations.

Our funeral homes offer a complete range of services to meet a family's funeral needs, including consultation, the removal and preparation of remains, the sale of caskets and related funeral merchandise, the use of funeral home facilities for visitation and remembrance services and transportation services. Most of our funeral homes have a non-denominational chapel on the premises, which permits family visitation and services to take place at one location and thereby reduces transportation costs and inconvenience to the family.

Funeral homes are principally service businesses that provide burial and cremation services and sell related merchandise, such as caskets and urns. The sources and availability of caskets and urns are from a small number of national providers that have distribution centers near our businesses. We typically order and receive the merchandise within 24 hours.

Given the high fixed-cost structure associated with funeral home operations, we believe the following are key factors affecting our profitability:

- our ability to establish and maintain market share positions supported by strong local heritage and relationships;
- our ability to effectively respond to the increasing trends towards cremation packaging complimentary services and merchandise;
- our ability to control salary, merchandise and other controllable costs;
- our ability to exercise pricing leverage related to our atneed business to increase average revenue per contract;

- demographic trends in terms of population growth and average age, which impact death rates and number of deaths; and
- our response to fluctuations in capital markets and interest rates, which affect investment earnings on trust funds and our securities portfolio within the trust funds, which would offset lower pricing power as preneed contracts mature.

Cemetery Operations

At December 31, 2018, we operated 29 cemeteries in 11 states. Cemetery revenue currently accounts for approximately 20% of our total revenue. The cemetery operations are managed by a team of experienced industry and sales professionals and regional leadership with substantial management experience in our industry. See Part II, Item 8, Financial Statements and Supplementary Data, Note 22 for segment data related to our cemetery operations.

Our cemetery products and services include interment services, the rights to interment in cemetery sites (primarily grave sites, mausoleum crypts and niches) and related cemetery merchandise, such as memorials and vaults. Cemetery operations generate revenue through sales of interment rights and memorials, installation fees, fees for interment and cremation memorialization products, finance charges from installment sales contracts and investment income from preneed cemetery merchandise trusts and perpetual care trusts. Cemetery revenue generated from atneed services and merchandise sales generally is subject to many of the same key profitability factors as our funeral home business. Our cemetery operating results are affected by the following key factors:

- size and success of our sales organization;
- local perceptions and heritage of our cemeteries;
- our ability to adapt to changes in the economy and consumer confidence; and
- our response to fluctuations in capital markets and interest rates, which affect investment earnings on trust funds, finance charges on installment contracts and our securities portfolio within the trust funds.

Preneed Programs

Funeral and cemetery arrangements sold prior to death occurring are referred to as preneed contracts. We market funeral and cemetery services and products on a preneed basis at the local level. Preneed funeral or cemetery contracts enable families to establish, in advance, the type of service to be performed, the products to be used and the cost of such products and services. Preneed contracts permit families to eliminate issues of making deathcare plans at the time of need and allow input from other family members before the death occurs. We guarantee the price and performance of the preneed contracts to the customer.

In addition to preneed funeral contracts, we also offer “pre-planned” funeral arrangements whereby a customer determines in advance substantially all of the details of a funeral service without any financial commitment or other obligation on the part of the client until the actual time of need. Pre-planned funeral arrangements permit a family to avoid issues of making deathcare plans at the time of need and enable a funeral home to establish relationships with a client that may eventually lead to an atneed sale.

We sold 7,444 and 8,303 preneed funeral contracts, net of cancellations, during the years ended December 31, 2017 and 2018, respectively. At December 31, 2018, we had a backlog of 96,310 preneed funeral contracts and 58,320 preneed cemetery contracts to be delivered in the future. Approximately 20% of our funeral contract volumes during the years ended December 31, 2017 and 2018 originated through preneed contracts. Cemetery revenue that originated from preneed contracts represented approximately 65% of our total cemetery revenue for 2017 and 2018.

At December 31, 2018, we employed a staff of 173 advance-planning and family service representatives for the sale of preneed products and services. Our advance-planning and family service representatives primarily assist families in making atneed and preneed funeral, memorialization and cemetery arrangements through the selection and purchase of cemetery property, merchandise and services and ensuring that the expectations of our client families and their guests are exceeded.

Trust Funds and Insurance Contracts

We have established a variety of trusts in connection with funeral home and cemetery operations as required under applicable state laws. Such trusts include (i) preneed funeral trusts; (ii) preneed cemetery merchandise and service trusts; and (iii) cemetery perpetual care trusts. These trusts are typically administered by independent financial institutions selected by us. Investment management and advisory services are provided either by our wholly-owned registered investment advisory firm, CSV RIA, or by independent financial advisors. As of December 31, 2018, CSV RIA provided these services to one institution, which has custody of approximately 75% of our trust assets, for a fee based on the market value of trust assets. Under state trust laws, we are allowed to charge the trust a fee for advising on the investment of the trust assets and these fees are recognized as income in the period in which services are provided. The investment advisors establish an investment policy that gives guidance on asset allocation, investment requirements, investment manager selection and performance monitoring. The investment objectives are tailored to generate long-term investment returns without assuming undue risk, while ensuring the management of assets is in compliance with applicable laws.

Preneed funeral sales generally require deposits to a trust or purchase of a third-party insurance product. Trust fund income earned, along with the receipt and recognition of any insurance benefits, are deferred until the service is performed or the merchandise is delivered. Trust fund holdings and deferred revenue are reflected on our Consolidated Balance Sheet, while the insurance contracts are not on our Consolidated Balance Sheet. In most states, we are not permitted to withdraw principal or investment income from such trusts until the funeral service is performed. Some states, however, allow for the retention of a percentage (generally 10%) of the receipts to offset any administrative and selling expenses. The aggregate balance of our preneed funeral contracts held in trust, insurance contracts and receivables from preneed trusts was \$487.3 million as of December 31, 2018.

We are generally required under applicable state laws to deposit a specified amount (which varies from state to state, generally 50% to 100% of the selling price) into a merchandise and service trust fund for preneed cemetery merchandise and services sales. The related trust fund income earned is recognized when the related merchandise and services are delivered. We are generally permitted to withdraw the trust principal and accrued income when the merchandise is actually delivered, when the service is provided or when the contract is canceled. However, certain states allow the withdrawal of income prior to delivery when the regulations identify excess earnings in the trusts. We did not withdraw any trust income in 2017 and 2018. Cemetery merchandise and service trust fund balances totaled \$62.4 million as of December 31, 2018.

In most states, regulations require a portion (generally 10%) of the sale amount of cemetery property and memorials to be placed in a perpetual care trust. The income from these perpetual care trusts provides funds necessary to maintain cemetery property and memorials in perpetuity. This trust fund income is recognized, as earned and is reflected in our Consolidated Financial Statements as *Other revenue*. While we are entitled to withdraw the income from perpetual care trusts to provide for maintenance of cemetery property and memorials, we are restricted from withdrawing any of the principal balances of the trust fund. Perpetual care trust balances totaled \$44.1 million at December 31, 2018.

For additional information with respect to our trusts, see Part II, Item 8, Financial Statements and Supplementary Data, Notes 7, 9 and 11.

SEASONALITY

Our business can be affected by seasonal fluctuations in the death rate. Generally, the number of deaths is higher during the winter months because the incidences of death from influenza and pneumonia are higher during this period than other periods of the year.

COMPETITION

The operating environment in the funeral and cemetery industry has been highly competitive. Publicly traded companies operating in the United States include SCI, StoneMor and Carriage. In addition, a number of smaller private consolidators have been active in acquiring and operating funeral homes and cemeteries.

Our funeral home and cemetery operations face competition in the markets that they serve. Our primary competition in most of our markets is from local independent operators. We have observed new start-up competition in certain areas of the country, which may impact our profitability in certain markets. Market share for funeral homes and cemeteries is largely a function of reputation and heritage, although competitive pricing, professional service and attractive, well-maintained and conveniently located facilities are also important. Because of the importance of reputation and heritage, market share increases are usually gained over a long period of time. The sale of preneed funeral services and cemetery property has increasingly been used by many companies as a marketing tool to build market share.

There has been increasing competition from providers specializing in specific services, such as cremations, who offer minimal service and low-end pricing. We also face competition from companies that market products and related merchandise over the

internet and non-traditional casket stores in certain markets. These competitors have been successful in capturing a portion of the low-end market and product sales.

REGULATION

General. Our operations are subject to regulations, supervision and licensing under numerous federal, state and local laws, ordinances and regulations, including extensive regulations concerning trust funds, preneed sales of funeral and cemetery products and services and various other aspects of our business. We believe that we comply in all material respects with the provisions of these laws, ordinances and regulations. Legislative bodies and regulatory agencies frequently propose new laws and regulations, some of which could have a material impact on our business. We cannot predict the impact of any future laws and regulations or changes to existing laws and regulations.

Federal Trade Commission. Our funeral home operations are comprehensively regulated by the Federal Trade Commission (“FTC”) under Section 5 of the Federal Trade Commission Act and a trade regulation rule for the funeral industry promulgated thereunder referred to as the “Funeral Rule.” The Funeral Rule defines certain acts or practices as unfair or deceptive and contains certain requirements to prevent these acts or practices. The preventive measures require a funeral provider to give consumers accurate, itemized pricing information and various other disclosures about funeral goods and services and prohibit a funeral provider from: (i) misrepresenting legal, crematory and cemetery requirements; (ii) embalming for a fee without permission; (iii) requiring the purchase of a casket for direct cremation; (iv) requiring consumers to buy certain funeral goods or services as condition for furnishing other funeral goods or services; (v) misrepresenting state and local requirements for an outer burial container; and (vi) representing that funeral goods and services have preservative and protective value. Additionally, the Funeral Rule requires the disclosure of mark-ups, commissions, additional charges and rebates related to cash advance items.

Environmental. Our operations are also subject to stringent federal, regional, state and local laws and regulations relating to environmental protection, including legal requirements governing air emissions, waste management and disposal and wastewater discharges. For instance, the federal Clean Air Act and analogous state laws, which restrict the emission of pollutants from many sources, including crematories, may require us to apply for and obtain air emissions permits, install costly emissions control equipment, and conduct monitoring and reporting tasks. Also, in the course of our operations, we store and use chemicals and other regulated substances as well as generate wastes that may subject us to strict liability under the federal Resource Conservation and Recovery Act and comparable state laws, which govern the treatment, storage, and disposal of nonhazardous and hazardous wastes, and the federal Comprehensive Environmental Response, Compensation and Liability Act, a remedial statute that imposes cleanup obligations on current and past owners or operators of facilities where hazardous substance releases occurred and anyone who transported or disposed or arranged for the transportation or disposal of hazardous substances released into the environment from such sites. In addition, the Federal Water Pollution Control Act, also known as the federal Clean Water Act, and analogous state laws regulate discharges of pollutants to state and federal waters. Underground and aboveground storage tanks that store chemicals and fuels for vehicle maintenance or general operations are located at certain of our facilities and any spills or releases from those facilities may cause us to incur remedial liabilities under the Clean Water Act or analogous state laws as well as potential liabilities for damages to properties or persons. Failure to comply with environmental laws and regulations could result in the assessment of sanctions, including administrative, civil, and criminal penalties, the imposition of investigatory, remedial and corrective action obligations, delays in permitting or performance of projects and the issuance of injunctions restricting or prohibiting some or all of our activities in affected areas. Moreover, accidental releases or spills may occur in the course of our operations, and we cannot assure you that we will not incur significant costs and liabilities as a result of such releases or spills, including any third party claims for damages to property, natural resources or persons. Also, it is possible that implementation of stricter environmental laws and regulations or more stringent enforcement of existing environmental requirements could result in additional, currently unidentifiable costs or liabilities to us, such as requirements to purchase pollution control equipment or implement operational changes or improvements. While we believe we are in substantial compliance with existing environmental laws and regulations, we cannot assure that we will not incur substantial costs in the future.

Worker Health and Safety. We are subject to the requirements of the federal Occupational Safety and Health Act, as amended (“OSHA”), and comparable state statutes whose purpose is to protect the health and safety of workers. In addition, the OSHA hazard communication standard, the Emergency Planning and Community Right to Know Act and implementing regulations and similar state statutes and regulations require that we organize and/or disclose information about hazardous materials used or produced in our operations and that this information be provided to employees, state and local governmental authorities and citizens. We believe that we are in substantial compliance with all applicable laws and regulations relating to worker health and safety.

EMPLOYEES

As of December 31, 2018, we and our subsidiaries employed 2,617 employees, of whom 1,069 were full-time and 1,548 were part-time. All of our funeral directors and embalmers possess licenses required by applicable regulatory agencies. None of our employees are represented by unions.

AVAILABLE INFORMATION

We file annual, quarterly and other reports, and any amendments to those reports, and information with the United States Securities and Exchange Commission (“SEC”). The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including us.

Our website address is www.carriageservices.com. Available on this website under “Investors – SEC Filings,” free of charge, are Carriage’s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, insider reports on Forms 3, 4 and 5 filed on behalf of directors and officers and amendments to those reports as soon as reasonably practicable after such materials are electronically filed with or furnished to the SEC.

Also posted on our website, and available in print upon request, are charters for our Audit Committee, Compensation Committee and Corporate Governance Committee. Copies of the Code of Business Conduct and Ethics and the Corporate Governance Guidelines are also posted on our website under “Investors – Corporate Governance.” Within the time period required by the SEC and the New York Stock Exchange, we will post on our website any modifications to the charters and any waivers applicable to senior officers as defined in the applicable charters, as required by the Sarbanes-Oxley Act of 2002. Information contained on our website is not part of this Form 10-K.

ITEM 1A. RISK FACTORS

RISKS RELATED TO OUR BUSINESS

The success of our businesses is typically dependent upon one or a few key employees for success because of the localized and personal nature of our business.

Funeral home and cemetery businesses have built local heritage and tradition through successive generations, providing a foundation for ongoing business opportunities from established client family relationships and related referrals. We believe these relationships build trust in the community and are a key driver to market share. Our businesses, which tend to serve small local markets, usually have one or a few key employees that drive our relationships. Our ability to attract and retain Managing Partners, sales force and other personnel is an important factor in achieving future success. We can give no assurance that we can retain these employees or that these relationships will drive market share. Our inability to attract and maintain qualified and productive Managing Partners and sales force could have a material adverse effect on our financial condition, results of operations and cash flows.

Our ability to execute our growth strategy is highly dependent upon our ability to successfully identify suitable acquisition candidates and negotiate transactions on favorable terms.

Our growth strategy is the primary way we expect to increase stockholder value. There is no assurance that we will be able to continue to identify acquisition candidates that meet our criteria or that we will be able to reach terms with identified candidates for transactions that are acceptable to us, and even if we do, we may not be able to successfully complete the transaction or integrate the new business into our existing business. We intend to apply standards established under our Strategic Acquisition Model to evaluate acquisition candidates, and there is no assurance that we will continue to be successful in doing so or that we will find attractive candidates that satisfy these standards. Due in part to the presence of competitors who have been in certain markets longer than we have, such acquisitions or investments may be more difficult or expensive than we anticipate.

Improved performance in our funeral and cemetery segments is dependent upon successful execution of our Standards Operating Model.

We have implemented our Standards Operating Model to improve and better measure performance in our funeral and cemetery operations. We developed standards according to criteria, each with a different weighting, designed around market share, people and operational and financial metrics. We also incentivize our location Managing Partners by giving them the opportunity to earn a fixed percentage of the field-level earnings before interest, taxes, depreciation and amortization based upon the number and weighting of the standards achieved. Our expectation is that, over time, the Standards Operating Model will result in improving field-level margins, market share, customer satisfaction and overall financial performance, but there is no assurance that these goals will be met. Failure to successfully implement our Standards Operating Model in our funeral and cemetery operations could have a material adverse effect on our financial condition, results of operations and cash flows.

Marketing and sales activities by existing and new competitors could cause us to lose market share and lead to lower revenue and margins.

We face competition in all of our markets. Most of our competitors are independently owned, and some are relatively recent market entrants. Some of the recent entrants are individuals who were formerly employed by us or by our competitors and have relationships and name recognition within our markets. As a group, independent competitors tend to be aggressive in distinguishing themselves by their independent ownership, and they promote their independence through television, radio and print advertising, direct mailings and personal contact. Increasing pressures from new market entrants and continued advertising and marketing by competitors in local markets could cause us to lose market share and revenue. In addition, competitors may change the types or mix of products or services offered. These changes may attract customers, causing us to lose market share and revenue as well as to incur costs in response to competition to vary the types or mix of products or services offered by us. Also, increased use of the internet by customers to research and/or purchase products and services could cause us to lose potential revenue.

Our “Good to Great” incentive program could result in significant future payments to our Managing Partners.

In January, 2012, in order to continue to align our Managing Partners’ incentives with the long-term interests of our stockholders, we implemented our “Good to Great” incentive program, which rewards our Managing Partners for achieving an average net revenue compounded annual growth rate equal to at least 2% (the “Minimum Growth Rate”) over a five year performance period (the “Performance Period”) with respect to our funeral homes that they operate. To date, we have had three Performance Periods ended December 31, 2016, December 31, 2017 and December 31, 2018. Each Managing Partner that achieves the Minimum Growth Rate during the applicable Performance Period and remains continuously employed as a Managing Partner of the same business throughout the Performance Period will receive a one-time bonus, payable in a combination of cash and shares of our common stock, determined at our discretion. We believe this incentive program will result in improved field-level margins, market share and overall financial performance.

Price competition could also reduce our market share or cause us to reduce prices to retain or recapture market share, either of which could reduce revenue and margins.

We have historically experienced price competition primarily from independent funeral home and cemetery operators, and from monument dealers, casket retailers, low-cost funeral providers and other non-traditional providers of services or products. New market entrants tend to attempt to build market share by offering lower cost alternatives. In the past, this price competition has resulted in our losing market share in some markets. In other markets, we have had to reduce prices or offer discounts thereby reducing profit margins in order to retain or recapture market share. Increased price competition in the future could further reduce revenue, profits and our preneed backlog.

Our ability to generate preneed sales depends on a number of factors, including sales incentives and local and general economic conditions.

Significant declines in preneed sales would reduce our backlog and revenue and could reduce our future market share. On the other hand, a significant increase in preneed sales can have a negative impact on cash flow as a result of commissions and other costs incurred initially without corresponding revenue.

As we have localized our preneed sales strategies, we are continuing to refine the mix of service and product offerings in both our funeral and cemetery segments, including changes in our sales commission and incentive structure. These changes could cause us to experience declines in preneed sales in the short-run. In addition, economic conditions at the local or national level could cause declines in preneed sales either as a result of less discretionary income or lower consumer confidence. Declines in preneed cemetery property sales reduces current revenue, and declines in other preneed sales would reduce our backlog and future revenue and could reduce future market share.

Increased preneed sales could have a negative impact on our cash flows.

Preneed sales of funeral and cemetery products and services generally have an initial negative impact on our cash flows, as we are required to deposit a portion of the sales proceeds into trusts or escrow accounts and often incur other expenses at the time of sale. Furthermore, many preneed purchases are paid for in installments over a period of several years, further reducing our cash flows at the time of sale. Because preneed sales generally provide positive cash flows over the long term, we market the sale of such contracts at the local level. If our efforts to increase such sales are successful, however, our current cash flows could be materially and adversely affected.

Our funeral and cemetery trust funds own investments in equity securities, fixed income securities, and mutual funds, which are affected by market conditions that are beyond our control.

In connection with our backlog of preneed funeral and preneed cemetery merchandise and service contracts, funeral and cemetery trust funds own investments in equity securities, fixed income securities and mutual funds. Our returns on these investments are affected by financial market conditions that are beyond our control.

The following table summarizes our investment returns (realized and unrealized), excluding certain fees, on our trust funds for the years ended December 31, 2016, 2017 and 2018:

	<u>2016</u>	<u>2017</u>	<u>2018</u>
Preneed funeral trust funds	17.0%	11.5%	(6.5)%
Preneed cemetery trust funds	19.6%	13.1%	(8.4)%
Perpetual care trust funds	19.2%	12.8%	(8.0)%

Generally, earnings or gains and losses on our preneed funeral and cemetery trust investments are recognized, and we withdraw cash, when the underlying service is performed, merchandise is delivered, or upon contract cancellation. Our cemetery perpetual care trusts recognize earnings, and in certain states, capital gains and losses, and we withdraw cash when we incur qualifying cemetery maintenance costs. If the investments in our trust funds experience significant, recurring and sustained declines in subsequent years, there could be insufficient funds in the trusts to cover the costs of delivering services and merchandise or maintaining cemeteries in the future. We may be required to cover any such shortfall with cash flows from operations or other sources of cash, which could have a material adverse effect on our financial condition, results of operations or cash flows. For more information related to our trust investments, see Part II, Item 8, Financial Statements and Supplementary Data, Notes 7, 9 and 11.

If the fair market value of these trusts, plus any other amount due to us upon delivery of the associated contracts, were to decline below the estimated costs to deliver the underlying products and services, we would record a charge to earnings to record a liability for the expected losses on the delivery of the associated contracts. For additional information, see Part II, Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations, Critical Accounting Policies and Estimates.

Earnings from and principal of trust funds could be reduced by changes in financial markets and the mix of securities owned.

Earnings and investment gains and losses on trust funds are affected by financial market conditions and the specific fixed-income and equity securities that we choose to maintain in the funds. We may not choose the optimal mix for any particular market condition. Declines in earnings from perpetual care trust funds would cause a decline in current revenue, while declines in earnings from other trust funds could cause a decline in future cash flows and revenue.

We may be required to replenish our funeral and cemetery trust funds in order to meet minimum funding requirements, which would have a negative effect on our earnings and cash flow.

In certain states, we have withdrawn allowable distributable earnings including gains prior to the maturity or cancellation of the related contract. Additionally, some states have laws that either require replenishment of investment losses under certain circumstances or impose various restrictions on withdrawals of future earnings when trust fund values drop below certain prescribed amounts. In the event of realized losses or market declines, we may be required to deposit portions or all of these amounts into the respective trusts in some future period.

Increasing death benefits related to preneed funeral contracts funded through life insurance contracts may not cover future increases in the cost of providing a price-guaranteed funeral service.

We sell price-guaranteed preneed funeral contracts through various programs providing for future funeral services at prices prevailing when the agreements are signed. For preneed funeral contracts funded through life insurance contracts, we receive in cash a general agency commission from the third-party insurance company. Additionally, there is an increasing death benefit associated with the contract that may vary over the contract life. There is no guarantee that the increasing death benefit will cover future increases in the cost of providing a price-guaranteed funeral service, and any such excess cost could be materially adverse to our future cash flows, revenue, and operating margins.

The financial condition of third-party insurance companies that fund our preneed funeral contracts may impact our future revenue.

Where permitted by state law, our customers may arrange their preneed funeral contract by purchasing a life insurance policy from third-party insurance companies. The customer/policy holder assigns the policy benefits to our funeral home to pay for the preneed funeral contract at the time of need. If the financial condition of the third-party insurance companies were to deteriorate materially because of market conditions or otherwise, there could be an adverse effect on our ability to collect all or part of the proceeds of the life insurance policy, including the annual increase in the death benefit, when we fulfill the preneed contract at the time of need. Failure to collect such proceeds could have a material adverse effect on our financial condition, results of operations, or cash flows.

Increased or unanticipated costs, such as insurance or other taxes, may have a negative impact on our earnings and cash flow.

We may experience material increases in certain costs, such as insurance or other taxes. Future cost increases are difficult to quantify and could materially and adversely affect our results of operations and cash flows.

New or revised tax regulations could have a material effect on our financial results.

The tax environment in which we operate is evolving rapidly with the recent enactment of sweeping corporate tax changes. On December 22, 2017, the U.S. enacted comprehensive tax legislation commonly known as the Tax Cuts and Jobs Act (the “Tax Act”). The Tax Act, among other things, contains significant changes to corporate taxation, including: (1) a reduction of the corporate tax rate from a top marginal rate of 35% to a flat rate of 21%; (2) a limitation of the tax deduction for interest expense to 30% of adjusted earnings (except for certain small businesses); (3) a limitation of the deduction for net operating losses to 80% of current year taxable income and elimination of net operating loss carrybacks; (4) limitations of certain executive compensation deductions; and (5) limitations or repeals of many business deductions and credits. The effect of the Tax Act on us may also be affected by future regulations and interpretations of the IRS regarding the Tax Act. Additionally, we operate in many states and are subject to the tax laws of those states. We are unable to predict how we may be affected by future changes, or lack of changes, to state tax laws that may be made in response to the Tax Act by the states in which we operate. Although the Tax Act had an overall positive impact on our earnings and cash flow for 2018 and, we believe it will have an overall beneficial impact on us for 2019, the longer term effect of the Tax Act on our business, cash flow, results of operations and financial condition is difficult to predict. Accordingly, the risk exists that the Tax Act, future IRS regulations and interpretations of the Tax Act and future changes in, or lack of changes in, state tax laws could materially and adversely affect our business cash flows, results of operations and financial condition.

Covenant restrictions under our debt instruments may limit our flexibility in operating and growing our business.

The terms of our New Credit Facility and the indenture governing our Senior Notes limit our ability and the ability of our subsidiaries to, among other things: incur additional debt; pay dividends or make distributions or redeem or repurchase stock; make investments; grant liens; make capital expenditures; enter into transactions with affiliates; enter into sale-leaseback transactions; sell assets; and acquire the assets of, or merge or consolidate with, other companies.

Our New Credit Facility also requires us to maintain certain financial ratios. Complying with these restrictive covenants and financial ratios, as well as those that may be contained in any future debt agreements, may limit our ability to finance our future operations or capital needs or to take advantage of other favorable business opportunities. Our ability to comply with these restrictive covenants and financial ratios will depend on our future performance, which may be affected by events beyond our control. Our failure to comply with any of these covenants or restrictions when they apply could result in a default under any future debt instrument, which could result in acceleration of the debt under that instrument and, in some cases, the acceleration of debt under other instruments that contain cross-default or cross-acceleration provisions. In the case of an event of default, or in the event of a cross-default or cross-acceleration, we may not have sufficient funds available to make the required payments under our debt instruments. If we are unable to repay amounts owed under the terms of our New Credit Facility, the lenders thereunder may be entitled to sell certain of our funeral assets to satisfy our obligations under the agreement.

Our level of indebtedness could adversely affect our financial condition and prevent us from fulfilling our debt obligations.

Our indebtedness requires significant interest and principal payments. As of December 31, 2018, we had \$367.4 million of total debt (excluding debt issuance costs, debt discounts and capital lease obligations), consisting of \$8.9 million of acquisition debt (consisting of deferred purchase price and promissory notes payable to sellers of businesses we purchased), \$6.3 million of carrying value of the liability of our Convertible Notes, \$325.0 million of our Senior Notes, and \$27.1 million of outstanding borrowings under our New Credit Facility, with \$120.9 million of availability under the New Credit Facility after giving effect to \$2.0 million of outstanding letters of credit.

Our and our subsidiaries’ level of indebtedness could have important consequences to us, including:

- continuing to require us and certain of our subsidiaries to dedicate a substantial portion of our cash flow from operations to the payment of our indebtedness, thereby reducing the funds available for operations and any future business opportunities;
- limiting flexibility in planning for, or reacting to, changes in our business or the industry in which we operate;
- placing us at a competitive disadvantage compared to our competitors that have less indebtedness;
- increasing our vulnerability to adverse general economic or industry conditions;
- making us and our subsidiaries more vulnerable to increases in interest rates, as borrowings under our New Credit Facility are at variable rates; and

- limiting our ability to obtain additional financing to fund working capital, capital expenditures, acquisitions or other general corporate requirements and increasing our cost of borrowing.

Our ability to make payments on and to refinance our indebtedness will depend on our ability to generate cash in the future from operations, financings or asset sales. Our ability to generate cash is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. We may not generate sufficient funds to service our debt and meet our business needs, such as funding working capital or the expansion of our operations. If we are not able to repay or refinance our debt as it becomes due, we may be forced to take certain actions, including reducing spending on day-to-day operations, reducing future financing for working capital, capital expenditures and general corporate purposes, selling assets or dedicating an unsustainable level of our cash flow from operations to the payment of principal and interest on our indebtedness. In addition, our ability to withstand competitive pressures and to react to changes in our industry could be impaired. The lenders who hold our debt could also accelerate amounts due in the event that we default, which could potentially trigger a default or acceleration of the maturity of our other debt, including the notes.

Additionally, our leverage could put us at a competitive disadvantage compared to our competitors that are less leveraged. These competitors could have greater financial flexibility to pursue strategic acquisitions and secure additional financing for their operations. Our leverage could also impede our ability to withstand downturns in our industry or the economy in general.

Despite our current levels of indebtedness, we may still incur additional indebtedness. This could further exacerbate the risks associated with our indebtedness.

We may incur additional indebtedness in the future. The terms of the New Credit Facility and the indenture governing our Senior Notes will limit, but not prohibit, us from incurring additional indebtedness. Additional indebtedness incurred in compliance with these restrictions could be substantial. These restrictions also do not prevent us or our subsidiaries from incurring obligations, such as trade payables, that do not constitute indebtedness as defined under our debt agreements. To the extent new debt is added to our current debt levels, the leverage risks associated with our indebtedness would increase.

Economic, financial and stock market fluctuations could affect future potential earnings and cash flows and could result in future goodwill, intangible assets and long-lived asset impairments.

In addition to an annual review, we assess the impairment of goodwill, intangible assets and other long-lived assets whenever events or changes in circumstances indicate that the carrying value may be greater than fair value. Factors that could trigger an interim impairment review include, but are not limited to, a significant decline in the market value of our stock or debt values, significant under-performance relative to historical or projected future operating results, and significant negative industry or economic trends. If these factors occur, we may have a triggering event, which could result in an impairment of our goodwill. Based on the results of our annual goodwill and intangible assets impairment test we performed as of August 31, 2018 and our annual review of long-lived assets as of December 31, 2018, we concluded that there was no impairment of our goodwill, intangible assets or other long-lived assets. However, during 2018, we recorded an impairment of \$0.8 million related to a funeral home business that we intend to cease operating in 2019, as the carrying value exceeded fair value. Additionally, if current economic conditions weaken causing deterioration in our operating revenue, operating margins and cash flows, we may have a triggering event that could result in a material impairment of our goodwill, intangible assets and/or long-lived assets.

We rely significantly on information technology and any failure, inadequacy, interruption or security lapse of that technology, including any cybersecurity incidents, could harm our ability to operate our business effectively.

In the ordinary course of our business, we receive certain personal information, in both physical and electronic formats, about our customers, their loved ones, our employees, and our vendors. We maintain substantial security measures and data backup systems to protect, store, and prevent unauthorized access to such information. Nevertheless, it is possible that computer hackers and others (through cyberattacks, which are rapidly evolving and becoming increasingly sophisticated, or by other means) might defeat our security measures in the future and obtain the personal information of customers, their loved ones, our employees, and our vendors that we hold. If we fail to protect our own information, we could experience significant costs and expenses as well as damage to our reputation. Additionally, legislation relating to cyber security threats could impose additional requirements on our operations.

Our ability to manage and maintain our internal reports effectively and integration of new business acquisitions depends significantly on our enterprise resource planning system and other information systems. Some of our information technology systems may experience interruptions, delays or cessations of service or produce errors in connection with ongoing systems implementation work. The failure of our systems to operate effectively or to integrate with other systems, or a breach in security or other unauthorized access of these systems, may also result in reduced efficiency of our operations and could require significant capital investments to remediate any such failure, problem or breach and to comply with applicable regulations, all of which could adversely affect our business, financial condition and results of operations.

RISKS RELATED TO THE FUNERAL AND CEMETERY INDUSTRY

Declines in the number of deaths in our markets can cause a decrease in revenue. Changes in the number of deaths are not predictable from market to market or over the short term.

Declines in the number of deaths could cause atneed sales of funeral and cemetery services, property and merchandise to decline, which could decrease revenue. Although the United States Bureau of the Census estimates that the number of deaths in the United States will increase in the future, longer life spans could reduce the rate of deaths. In addition, changes in the number of deaths can vary among local markets and from quarter to quarter, and variations in the number of deaths in our markets or from quarter to quarter are not predictable. These variations may cause our revenue to fluctuate and our results of operations to lack predictability.

The increasing number of cremations in the United States could cause revenue to decline because we could lose market share to firms specializing in cremations.

Our traditional cemetery and funeral service operations face competition from the increasing number of cremations in the United States. Industry studies indicate that the percentage of cremations has increased every year and this trend is expected to continue into the future. The trend toward cremation could cause cemeteries and traditional funeral homes to lose market share and revenue to firms specializing in cremations.

If we are not able to respond effectively to changing consumer preferences, our market share, revenue and profitability could decrease.

Future market share, revenue and profits will depend in part on our ability to anticipate, identify and respond to changing consumer preferences. In past years, we have implemented new product and service strategies based on results of customer surveys that we conduct on a continuous basis. However, we may not correctly anticipate or identify trends in consumer preferences, or we may identify them later than our competitors do. In addition, any strategies we may implement to address these trends may prove incorrect or ineffective.

Because the funeral and cemetery businesses are high fixed-cost businesses, changes in revenue can have a disproportionately large effect on cash flow and profits.

Companies in the funeral home and cemetery business must incur many of the costs of operating and maintaining facilities, land and equipment regardless of the level of sales in any given period. For example, we must pay salaries, utilities, property taxes and maintenance costs on funeral homes and maintain the grounds of cemeteries regardless of the number of funeral services or interments performed. Because we cannot decrease these costs significantly or rapidly when we experience declines in sales, declines in sales can cause margins, profits and cash flow to decline at a greater rate than the decline in revenue.

Changes or increases in, or failure to comply with, regulations applicable to our business could increase costs or decrease cash flows.

The funeral and cemetery industry is subject to extensive and evolving regulation and licensing requirements under federal, state and local laws. For example, the funeral home industry is regulated by the FTC, which requires funeral homes to take actions designed to protect consumers. State laws impose licensing requirements and regulate preneed sales. As such, we are subject to state trust fund and preneed sales practice audits, which could result in audit adjustments as a result of non-compliance. In addition, we assume the liability for any audit adjustments for our acquired businesses for periods under audit that were prior to our ownership of the business. These audit adjustments could have a material adverse impact on our financial condition, results of operations and cash flows.

Embalming and cremation facilities are subject to stringent environmental and health regulations. Compliance with these regulations is burdensome, and we are always at risk of not complying with the regulations or facing costly and burdensome investigations from regulatory authorities.

In addition, from time to time, governments and agencies propose to amend or add regulations, which could increase costs or decrease cash flows. Several states and regulatory agencies have considered or are considering regulations that could require more liberal refund and cancellation policies for preneed sales of products and services, limit or eliminate our ability to use surety bonding, increase trust requirements and/or prohibit the common ownership of funeral homes and cemeteries in the same market. If adopted by the regulatory authorities of the jurisdictions in which we operate, these and other possible proposals could have a material adverse effect on us, our financial condition, our results of operations and our future prospects. For additional information regarding the regulation of the funeral and cemetery industry, see Part I, Item 1, Business, Regulation.

We are subject to environmental and worker health and safety laws and regulations that may expose us to significant costs and liabilities.

Our cemetery and funeral home operations are subject to stringent federal, regional, state and local laws and regulations governing worker health and safety aspects of the operations, the release or disposal of materials into the environment or otherwise relating to environmental protection. These laws and regulations may restrict or impact our business in many ways, including requiring the acquisition of a permit before conducting regulated activities, restricting the types, quantities and concentration of substances that can be released into the environment, applying specific health and safety criteria addressing worker protection, and imposing substantial liabilities for any pollution resulting from our operations. We may be required to make significant capital and operating expenditures to comply with these laws and regulations and any failure to comply may result in the assessment of sanctions, including administrative, civil and criminal penalties, imposition of investigatory, remedial or corrective action obligations, delays in permitting or performance of projects and the issuance of injunctions restricting or prohibiting our activities. Failure to appropriately transport and dispose of generated wastes, used chemicals or other regulated substances, or any spills or other unauthorized releases of regulated substances in the course of our operations could expose us to material losses, expenditures and liabilities under applicable environmental laws and regulations, and result in neighboring landowners and other third parties filing claims for personal injury, property damage and natural resource damage allegedly caused by such non-compliant activities or spills or releases. Certain of these laws may impose strict, joint and several liabilities upon us for the remediation of contaminated property resulting from our or a predecessor owner's or operator's operations. We may not be able to recover some or any of these costs from insurance or contractual indemnifications. Moreover, changes in environmental laws, regulations and enforcement policies occur frequently, and any changes that result in more stringent or costly emissions control or waste handling, storage, transport, disposal or cleanup requirements could require us to make significant expenditures to attain and maintain compliance and may otherwise have a material adverse effect on our results of operations, competitive position or financial condition.

Burial practice claims could have a material adverse impact on our financial results.

From time to time, we are party to various claims and legal proceedings, including burial practices. When cemetery disputes occur, we may be subjected to litigation and liability for improper burial practices. In addition, since we acquired most of our cemeteries through various acquisitions, we may be subject to litigation and liability based upon actions or events that occurred before we acquired or managed the cemeteries. Claims or litigation based upon our cemetery burial practices could have a material adverse impact on our financial condition, results of operations and cash flows.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

At December 31, 2018, we operated 182 funeral homes in 29 states and 29 cemeteries in 11 states. We own the real estate and buildings for 159 of our funeral homes and lease 23 facilities. We own 28 cemeteries and operate one cemetery under a long-term contract with a municipality, which we refer to as a managed property. We operate 16 funeral homes in combination with cemeteries as these locations are physically located on the same property or in very close proximity and are under the same leadership.

The 29 cemeteries operated by us have an inventory of unsold developed lots totaling approximately 146,000 and 129,000 at December 31, 2017 and 2018, respectively. In addition, we own approximately 450 acres that are available for future development or sale. We anticipate having a sufficient inventory of lots to maintain our property sales for the foreseeable future.

The following table sets forth certain information as of December 31, 2018, regarding our properties used by the funeral home segment and by the cemetery segment identified by state:

State	Number of Funeral Homes		Number of Cemeteries	
	Owned	Leased ⁽¹⁾	Owned	Managed
California	23	5	4	—
Colorado	2	—	—	—
Connecticut	8	2	—	—
Florida	11	5	5	—
Georgia	4	—	—	—
Idaho	5	1	3	—
Illinois	2	1	1	—
Kansas	2	—	—	—
Kentucky	8	1	1	—
Louisiana	3	1	1	—
Maryland	1	—	—	—
Massachusetts	12	—	—	—
Michigan	2	—	—	—
Montana	2	1	1	—
Nevada	2	—	2	1
New Jersey	4	1	—	—
New Mexico	1	—	—	—
New York	6	1	—	—
North Carolina	7	1	1	—
Ohio	5	—	—	—
Oklahoma	6	—	2	—
Pennsylvania	2	—	—	—
Rhode Island	4	—	—	—
Tennessee	5	—	—	—
Texas	21	1	7	—
Virginia	7	1	—	—
Washington	2	—	—	—
West Virginia	1	1	—	—
Wisconsin	1	—	—	—
Total	159	23	28	1

(1) The leases, with respect to these funeral homes, generally have remaining terms ranging from one to fifteen years, and generally, we have the right to renew past the initial terms and have a right of first refusal on any proposed sale of the property where these funeral homes are located.

Our Houston support home office occupies approximately 48,000 square feet of leased office space in Houston, Texas. At December 31, 2018, we owned and operated 743 vehicles.

The following table sets forth the number of funeral homes and cemeteries owned and operated by us for the periods presented:

	Year Ended December 31,		
	2016	2017	2018
Funeral homes at beginning of period	167	170	178
Acquisitions	6	7	4
Constructed funeral homes	—	2	—
Divestitures	(1)	(1)	—
Mergers and relocation of funeral homes	(2)	—	—
Funeral homes at end of period	<u>170</u>	<u>178</u>	<u>182</u>
Cemeteries at beginning of period	32	32	32
Acquisitions	—	—	—
Divestitures	—	—	(3)
Cemeteries at end of period	<u>32</u>	<u>32</u>	<u>29</u>

ITEM 3. LEGAL PROCEEDINGS.

We and our subsidiaries are parties to a number of legal proceedings that arise from time to time in the ordinary course of our business. While the outcome of these proceedings cannot be predicted with certainty, we do not expect these matters to have a material adverse effect on our financial statements. Information regarding litigation is set forth in Part II, Item 8, Financial Statements and Supplementary Data, Note 17.

Faria, et al. v. Carriage Funeral Holdings, Inc., Superior Court of California, Contra Costa County, Case No. MSC18-00606. On March 26, 2018, six Plaintiffs filed a putative class action against Carriage Funeral Holdings, Inc., our subsidiary, their alleged employer, on behalf of themselves and all similarly situated current and former employees. Plaintiffs seek monetary damages and claim that Carriage Funeral Holdings, Inc. failed to pay minimum wages, provide meal and rest breaks, provide accurately itemized wage statements, reimburse employees for required expenses, and provide wages when due. Plaintiffs also claim that Carriage Funeral Holdings, Inc. violated California Business and Professions Code §17200 et seq. On June 5, 2018, Plaintiffs filed a First Amended Complaint to add a claim under the California Private Attorney General Act. On October 23, 2018, the parties mediated this matter and executed a Memorandum of Understanding for class settlement. In February 2019, a Class Action Settlement Agreement was fully executed, which will be submitted to the Court for preliminary approval. We anticipate that the Court will preliminarily approve the Class Action Settlement Agreement in 2019. If the Class Action Settlement Agreement is preliminarily approved by the Court, the class claims process will then proceed. At December 31, 2018, we have accrued \$650,000 for the estimated settlement amount related to this case.

We self-insure against certain risks and carry insurance with coverage and coverage limits for risks in excess of the coverage amounts consistent with our assessment of risks in our business and of an acceptable level of financial exposure. Although there can be no assurance that self-insurance reserves and insurance will be sufficient to mitigate all damages, claims or contingencies, we believe that the reserves and our insurance provide reasonable coverage for known asserted and unasserted claims. In the event we sustain a loss from a claim and the insurance carrier disputes coverage or coverage limits, we may record a charge in a different period than the recovery, if any, from the insurance carrier.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

MARKET INFORMATION

Our common stock is traded on the New York Stock Exchange under the symbol “CSV.” As of February 22, 2019, there were 18,183,198 shares of our common stock outstanding. The shares of common stock outstanding are held by approximately 400 stockholders of record. Each share is entitled to one vote on matters requiring the vote of stockholders. We believe there are approximately 6,000 beneficial owners of our common stock.

RECENT SALES OF UNREGISTERED SECURITIES

During the year ended December 31, 2018, we did not have any sales of securities in transactions that were not registered under the Securities Act that have not been reported in a Form 8-K or Form 10-Q.

DIVIDENDS

While we intend to pay regular quarterly cash dividends for the foreseeable future, covenant restrictions under our New Credit Facility and the indenture governing our Senior Notes may limit our ability to pay dividends in the future.

EQUITY PLANS

For information regarding securities authorized for issuance under our equity compensation plans, see Part III, Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

PURCHASES OF EQUITY SECURITIES BY THE ISSUER

On February 25, 2016, our Board approved a share repurchase program authorizing us to purchase up to an aggregate of \$25.0 million of our common stock in accordance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). On October 25, 2017, our Board approved a \$15.0 million increase in its authorization for repurchases of our common stock in addition to the \$25.0 million approved on February 25, 2016, bringing the total authorized repurchase amount to \$40.0 million, in accordance with the Exchange Act.

During the year ended December 31, 2018, we repurchased 1,101,969 shares of common stock for a total cost of \$17.7 million at an average cost of \$16.03 per share pursuant to this share repurchase program. Our shares were purchased in the open market. Purchases were at times and in amounts as management determined appropriate based on factors such as market conditions, legal requirements and other business considerations. Shares purchased pursuant to the repurchase program are currently held as treasury shares. At December 31, 2018, we had approximately \$8.3 million available for repurchase under this share repurchase program.

The following table sets forth certain information with respect to repurchases of our common stock during the quarter ended December 31, 2018:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Dollar Value of Shares That May Yet Be Purchased Under the Program⁽¹⁾
October 1, 2018 - October 31, 2018	—	\$ —	—	\$ 26,019,052
November 1, 2018 - November 30, 2018	411,227	\$ 16.65	411,227	\$ 19,170,594
December 1, 2018 - December 31, 2018	690,742	\$ 15.65	690,742	\$ 8,357,192
Total for quarter ended December 31, 2018	1,101,969		1,101,969	

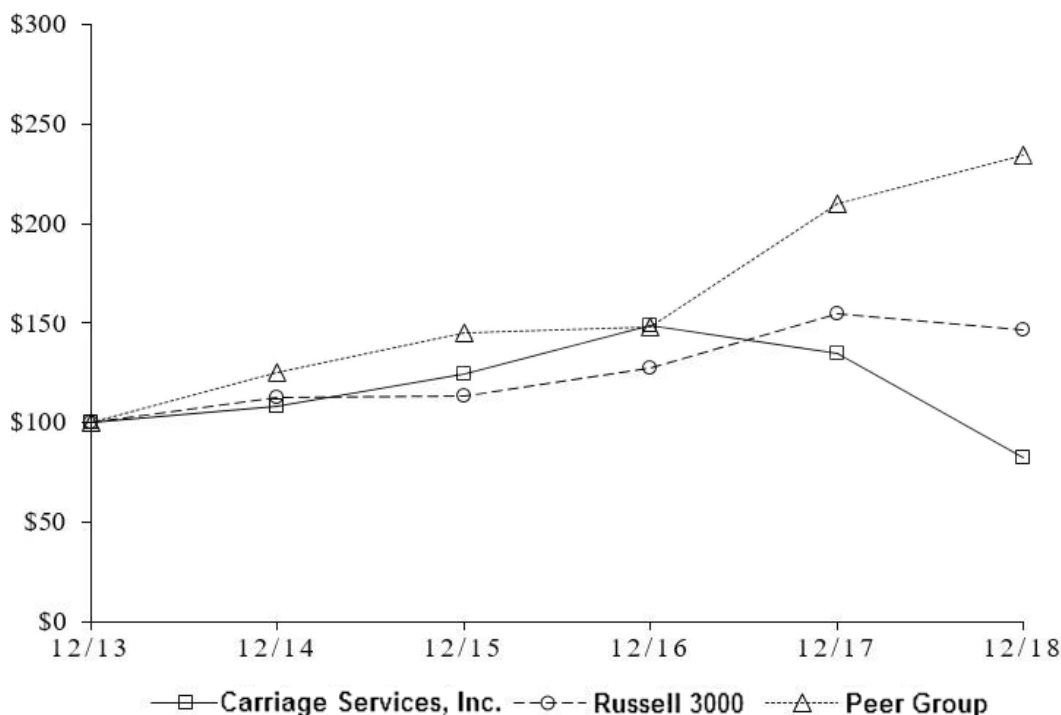
(1) See the first paragraph under the caption “– Purchases of Equity Securities by the Issuer” for more information on our publicly announced share repurchase program.

PERFORMANCE

The following graph compares the cumulative 5-year total return provided to shareholders on our common stock relative to the cumulative total returns of the Russell 3000 Index, and a customized peer group of two companies that includes SCI and StoneMor. The returns of each member of the peer group are weighted according to each member's stock market capitalization as of the beginning of each period measured. The graph assumes that the value of the investment in our common stock, the Russell 3000 Index and the peer group was \$100 on the last trading day of December 2013, and that all dividends were reinvested. Performance data for Carriage, the Russell 3000 Index and the peer group is provided as of the last trading day of each of our last five fiscal years.

The following graph and related information shall not be deemed "soliciting material" or "filed" with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN⁽¹⁾
Among Carriage Services, Inc., the Russell 3000 Index and a Peer Group



	12/13	12/14	12/15	12/16	12/17	12/18
Carriage Services, Inc.	\$ 100.00	\$ 107.86	\$ 124.61	\$ 149.04	\$ 134.97	\$ 82.47
Russell 3000	100.00	112.55	113.09	127.47	154.40	146.29
Peer Group	100.00	125.26	145.13	148.16	210.39	234.10

(1) Fiscal year ending December 31. \$100 invested on December 31, 2013 in stock or index, including reinvestment of dividends. Peer Group includes SCI and StoneMor. The stock price performance included in this graph is not necessarily indicative of future stock price performance.

ITEM 6. SELECTED FINANCIAL DATA.

The table below sets forth selected consolidated financial information for us that has been derived from the audited Consolidated Financial Statements of the Company as of and for each of the years ended December 31, 2014, 2015, 2016, 2017 and 2018. These historical results are not indicative of our future performance.

You should read this historical financial data together with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in this Form 10-K and our Consolidated Financial Statements and notes thereto included elsewhere in this Form 10-K.

	Year ended December 31,				
	2014	2015	2016	2017	2018
	(dollars in thousands, except per share amounts)				
INCOME STATEMENT DATA:					
Revenue	\$ 226,124	\$ 242,502	\$ 248,200	\$ 258,139	\$ 267,992
Gross profit	70,008	77,508	79,650	76,799	75,947
Operating income	39,715	48,648	50,204	48,941	43,307
Income before income taxes	22,701	34,590	32,241	32,782	18,266
Net income attributable to common shareholders	15,838	20,853	19,581	37,193	11,645
Basic earnings per share	\$ 0.86	\$ 1.16	\$ 1.18	\$ 2.25	\$ 0.64
Diluted earnings per share	\$ 0.85	\$ 1.12	\$ 1.12	\$ 2.09	\$ 0.63
Dividends declared per share	\$ 0.100	\$ 0.100	\$ 0.150	\$ 0.225	\$ 0.300
Weighted average number of common and common equivalent shares outstanding:					
Basic	18,108	17,791	16,515	16,438	17,971
Diluted	18,257	18,317	17,460	17,715	18,374
BALANCE SHEET DATA:					
Total assets	\$ 827,528	\$ 833,139	\$ 885,069	\$ 921,533	\$ 917,502
Long-term debt and credit facility, net of current maturities	152,387	195,009	204,404	212,154	33,070
Convertible subordinated notes	114,542	115,227	119,596	124,441	5,732
Stockholders’ equity	179,875	157,594	175,734	197,656	221,492

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**OVERVIEW***General*

We operate in two business segments: funeral home operations, which accounts for approximately 80% of our revenue, and cemetery operations, which accounts for approximately 20% of our revenue. Our funeral homes offer a complete range of high value personal services to meet a family’s funeral needs, including consultation, the removal and preparation of remains, the sale of caskets and related funeral merchandise, the use of funeral home facilities for visitation and remembrance services and transportation services. Our cemeteries provide interment rights (grave sites and mausoleum spaces) and related merchandise, such as markers and outer burial containers. We provide funeral and cemetery services and products on both an “atneed” (time of death) and “preneed” (planned prior to death) basis.

At December 31, 2018, we operated 182 funeral homes in 29 states and 29 cemeteries in 11 states within the United States. For additional discussion about our overall business strategy, see Part I, Item 1, Business – Business Strategy.

Funeral Home Operations

Factors affecting our funeral operating results include: demographic trends relating to population growth and average age, which impact death rates and number of deaths; establishing and maintaining leading market share positions supported by strong local heritage and relationships; effectively responding to increasing cremation trends by selling complementary services and merchandise; controlling salary and merchandise costs; and exercising pricing leverage related to our atneed business to increase

average revenue per contract. In simple terms, volume and price are the two variables that affect funeral revenue. The average revenue per contract is influenced by the mix of traditional and cremation services because our average cremation service revenue is approximately one-third of the average revenue earned from a traditional burial service. Funeral homes have a relatively fixed cost structure.

Cemetery Operations

Factors affecting our cemetery operating results include: the size and success of our sales organization; local perceptions and heritage of our cemeteries; our ability to adapt to changes in the economy and consumer confidence; and our response to fluctuations in capital markets and interest rates, which affect investment earnings on trust funds, finance charges on installment contracts and our securities portfolio within the trust funds.

LIQUIDITY AND CAPITAL RESOURCES

Overview

Our primary sources of liquidity and capital resources are internally generated cash flows from operating activities and availability under our New Credit Facility.

We generate cash in our operations primarily from atneed sales and delivery of preneed sales. We also generate cash from earnings on our cemetery perpetual care trusts. Based on our recent operating results, current cash position and anticipated future cash flows, we do not anticipate any significant liquidity constraints in the foreseeable future. However, if our capital expenditures or acquisition plans change, we may need to access the capital markets to obtain additional funding. Further, to the extent operating cash flow or access to and cost of financing sources are materially different than expected, future liquidity may be adversely affected. Please read Part I, Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2018.

We intend to use cash on hand and borrowings under our New Credit Facility primarily to acquire funeral home and cemetery businesses and for internal growth projects, such as cemetery inventory development and funeral home expansion projects, and for payment of dividends and our debt obligations. From time to time we may also use available cash resources (including borrowings under our New Credit Facility) to repurchase shares of our common stock and our remaining Convertible Notes in open market or privately-negotiated transactions. We have the ability to draw on our New Credit Facility, subject to its customary terms and conditions. We believe that our existing and anticipated cash resources will be sufficient to meet our anticipated working capital requirements, capital expenditures, scheduled debt payments, commitments, dividends and acquisitions for the foreseeable future.

Balance Sheet Recapitalization

On April 25, 2018, we entered into an eighth amendment and commitment increase (the “Eighth Amendment”) to our former secured credit facility, dated as of August 30, 2012 (as amended, the “Former Credit Agreement”), which amended the Former Credit Agreement to, among other things, increase the aggregate revolving credit commitment available thereunder to \$200 million.

On May 7, 2018, we completed privately-negotiated exchanges (the “Exchange”) of approximately \$115 million in aggregate principal amount of our 2.75% Convertible Notes, which represented approximately 80% of the aggregate principal amount of our Convertible Notes then outstanding, for an aggregate of \$75.2 million in cash and 2,822,859 newly issued shares of our common stock.

On May 31, 2018, we completed the issuance of \$325 million in aggregate principal amount of Senior Notes in a private offering. We used \$291.4 million of the net proceeds from the sale of the Senior Notes to repay all amounts outstanding under our Former Credit Agreement and all commitments thereunder were terminated.

On May 31, 2018, in connection with the issuance of the Senior Notes, we entered into a \$150 million New Credit Facility with certain of our subsidiaries, as guarantors, the financial institutions party thereto, as lenders, and Bank of America, N.A., as administrative agent.

On December 24, 2018, we completed privately-negotiated repurchases of an additional \$22.4 million in aggregate principal amount of Convertible Notes, which represented 78% of the aggregate principal amount of our Convertible Notes then outstanding, for \$23.0 million in cash, leaving a principal balance of \$6.3 million outstanding as of December 31, 2018. We increased our borrowings under the New Credit Facility to fund the purchase price for the repurchases.

Cash Flows

We began 2018 with \$1.0 million in cash and other liquid investments and ended the year with \$0.6 million in cash. At December 31, 2018, we had borrowings of \$27.1 million outstanding on our New Credit Facility compared to \$92.0 million outstanding under our Former Credit Agreement as of December 31, 2017 and \$67.7 million outstanding as of December 31, 2016.

The following table sets forth the elements of cash flow for the years ended December 31, 2016, 2017 and 2018 (in thousands):

	<u>2016</u>	<u>2017</u>	<u>2018</u>
Cash at beginning of year	\$ 535	\$ 3,286	\$ 952
Cash flow from operating activities	50,035	45,230	48,994
Acquisitions and land for new construction	(26,556)	(28,799)	(37,970)
Purchase of land and buildings previously leased	(6,258)	—	—
Net proceeds from the sale of businesses and other assets	4,385	5,731	—
Growth capital expenditures	(9,444)	(7,973)	(4,260)
Maintenance capital expenditures	(7,402)	(8,422)	(9,266)
Cash flow from investing activities	<u>(45,275)</u>	<u>(39,463)</u>	<u>(51,496)</u>
Net borrowings (payments) on long-term debt obligations	1,124	11,088	(194,340)
Payment of debt issuance costs related to long-term debt	—	—	(1,751)
Acquisition of Convertible Notes	—	—	(98,266)
Transaction costs related to the acquisition of Convertible Notes	—	—	(885)
Proceeds from the issuance of the Senior Notes	—	—	320,125
Payment of debt issuance costs related to the Senior Notes	—	—	(1,367)
Dividends paid on common stock	(2,492)	(3,709)	(5,513)
Net proceeds from employee equity plans	—	886	457
Purchase of treasury stock	—	(16,366)	(16,266)
Payment of loan origination costs related to the Former Credit Agreement	(717)	—	—
Other financing costs	76	—	—
Cash flow from financing activities	<u>(2,009)</u>	<u>(8,101)</u>	<u>2,194</u>
Cash at end of year	<u>\$ 3,286</u>	<u>\$ 952</u>	<u>\$ 644</u>

Operating Activities

For the year ended December 31, 2018, cash provided by operating activities was \$49.0 million compared to \$45.2 million for the year ended December 31, 2017 and \$50.0 million for the year ended December 31, 2016. The increase of \$3.8 million for the year ended December 31, 2018 compared to the year ended December 31, 2017 was due primarily to the favorable impact of working capital changes.

The decrease of \$4.8 million for the year ended December 31, 2017 compared to the year ended December 31, 2016 was primarily due to a decline in preneed cemetery revenue and acquired funeral home operating profit in 2017 and working capital changes, which include the timing of payments for income taxes, payments for accrued severance for the retirement of a former executive and our **Good To Great** incentive compensation plan during the first quarter of 2017.

Investing Activities

Our investing activities resulted in a net cash outflow of \$51.5 million for the year ended December 31, 2018 compared to \$39.5 million for the year ended December 31, 2017 and \$45.3 million for the year ended December 31, 2016, an increase of \$12.0 million and a decrease of \$5.8 million, respectively.

During the year ended December 31, 2018, we acquired four funeral home businesses, two in Virginia, one in Tennessee, and one in North Carolina for an aggregate purchase price of \$38.0 million.

During the year ended December 31, 2017, we acquired seven funeral home businesses, two in Colorado and five in New York for an aggregate purchase price of \$27.5 million. We also purchased real estate for funeral home parking lot expansion projects for \$1.3 million.

During the year ended December 31, 2016, we acquired six funeral home businesses, two in Houston, Texas, one in Madera, California, one in Brookfield, Wisconsin, one in Burlington, North Carolina and one in Graham, North Carolina for the aggregate purchase price of \$32.8 million.

For the year ended December 31, 2018, capital expenditures totaled \$13.5 million compared to \$16.4 million for the year ended December 31, 2017, and \$16.8 million for the year ended December 31, 2016, a decrease of \$2.9 million and a decrease of \$0.4 million, respectively.

The following tables present our growth and maintenance capital expenditures (in millions):

	<u>2016</u>	<u>2017</u>	<u>2018</u>
<i>Growth</i>			
Cemetery development	\$ 4.0	\$ 3.7	\$ 3.1
Construction for new funeral facilities	3.1	3.1	—
Renovations at certain businesses	2.3	1.2	1.1
Total Growth	<u>\$ 9.4</u>	<u>\$ 8.0</u>	<u>\$ 4.2</u>
	<u>2016</u>	<u>2017</u>	<u>2018</u>
<i>Maintenance</i>			
Facility repairs and improvements	\$ 2.4	\$ 2.2	\$ 2.6
General equipment and furniture	2.1	2.0	2.2
Vehicles	1.5	1.9	2.6
Paving roads and parking lots	0.7	1.3	0.7
Information technology infrastructure improvements	0.7	1.0	1.2
Total Maintenance	<u>\$ 7.4</u>	<u>\$ 8.4</u>	<u>\$ 9.3</u>

Financing Activities

Our financing activities resulted in a net cash inflow of \$2.2 million for the year ended December 31, 2018 compared to a net cash outflow of \$8.1 million for the year ended December 31, 2017 and net cash outflow of \$2.0 million for the year ended December 31, 2016. For the year ended December 31, 2018, we had net proceeds related to the issuance of our Senior Notes of \$318.8 million, offset by net payments on our long-term debt obligations of \$196.1 million and payments of \$99.2 million to acquire our Convertible Notes. We purchased treasury stock for \$16.3 million and paid \$5.5 million in dividends on our common stock.

For the year ended December 31, 2017, we had net borrowings on our long-term debt obligations of \$11.1 million. We purchased treasury stock for \$16.4 million and paid \$3.7 million in dividends on our common stock.

For the year ended December 31, 2016, we had net borrowings on our long-term debt obligations of \$1.1 million. We paid \$2.5 million in dividends on our common stock and paid transactions costs of \$0.7 million related to the Seventh Amendment to our Former Credit Agreement.

Dividends

On October 25, 2017, our Board approved an increase in our quarterly dividend on our common stock from \$0.050 to \$0.075 per share, effective with respect to dividends payable on December 1, 2017 and later.

For the years ended December 31, 2018, 2017 and 2016, our Board declared the following dividends payable on the dates below (in millions, except per share amounts):

<u>2018</u>	<u>Per Share</u>	<u>Dollar Value</u>
March 1st	\$ 0.075	\$ 1.2
June 1st	\$ 0.075	\$ 1.4
September 1st	\$ 0.075	\$ 1.4
December 1st	\$ 0.075	\$ 1.4

<u>2017</u>	<u>Per Share</u>	<u>Dollar Value</u>
March 1st	\$ 0.050	\$ 0.8
June 1st	\$ 0.050	\$ 0.8
September 1st	\$ 0.050	\$ 0.8
December 1st	\$ 0.075	\$ 1.2

<u>2016</u>	<u>Per Share</u>	<u>Dollar Value</u>
March 1st	\$ 0.025	\$ 0.4
June 1st	\$ 0.025	\$ 0.4
September 1st	\$ 0.050	\$ 0.8
December 1st	\$ 0.050	\$ 0.8

Share Repurchases

On February 25, 2016, our Board approved a share repurchase program authorizing us to purchase up to an aggregate of \$25.0 million of our common stock in accordance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). On October 25, 2017, our Board approved a \$15.0 million increase in its authorization for repurchases of our common stock in addition to the \$25.0 million approved on February 25, 2016, bringing the total authorized repurchase amount to \$40.0 million, in accordance with the Exchange Act.

During the year ended December 31, 2018, we repurchased 1,101,969 shares of common stock for a total cost of approximately \$17.7 million at an average cost of \$16.03 per share pursuant to our share repurchase program. Our shares were purchased in the open market at times and in amounts as management determined appropriate based on factors such as market conditions, legal requirements and other business considerations. Shares purchased pursuant to the repurchase program are currently held as treasury shares. At December 31, 2018, we had approximately \$8.3 million available for repurchase under our share repurchase program.

During the year ended December 31, 2017, we repurchased 574,054 shares of common stock for a total cost of approximately \$14.0 million at an average cost of \$24.35 per share pursuant to our share repurchase program. Our shares were purchased in the open market at times and in amounts as management determined appropriate based on factors such as market conditions, legal requirements and other business considerations. Shares purchased pursuant to the repurchase program are currently held as treasury shares. At December 31, 2017, we had approximately \$26.0 million available for repurchase under our share repurchase program.

On August 18, 2017, we purchased 100,000 shares of our common stock from Melvin C. Payne, our Chairman of the Board and Chief Executive Officer. The purchase of these shares was made pursuant to a privately-negotiated transaction at a price of \$23.85 per share for a total purchase price of \$2.4 million. The purchase price we paid for these shares was the stock's trading price at the time of the transaction. This purchase was not a part of the share repurchase program approved by the Board on February 25, 2016. The repurchase of the shares held by Mr. Payne was approved in advance by our Board, with Mr. Payne abstaining. See Note 26 to our Consolidated Financial Statements included herein for additional information on our related party transactions.

We did not purchase any shares of our common stock during 2016.

Long-term Debt

On April 25, 2018, we entered into an eighth amendment, which amended the Former Credit Agreement as follows:

(i) increase the aggregate revolving credit commitment to \$200.0 million;

(ii) permit the Company to use the proceeds of revolving loans (a) to repay certain indebtedness; (b) for working capital and acquisitions; (c) to make certain capital expenditures; (d) to pay interest on certain subordinated indebtedness and refinancing indebtedness (subject to the satisfaction of certain terms and conditions); (e) to prepay, repay, purchase or redeem certain subordinated indebtedness; and (f) for general corporate purposes;

(iii) modify the maximum senior secured leverage ratio covenant; and

(iv) release the mortgage liens of the Administrative Agent on certain real property collateral located in a flood plain, among other things.

Following the effectiveness of the Eighth Amendment, the Former Credit Agreement was comprised of a \$200.0 million revolving credit facility and a \$150.0 million term loan. Under the Former Credit Agreement, as amended by the Eighth Amendment, we were required to comply with a covenant to maintain a maximum senior secured leverage ratio. We incurred \$0.7 million in transaction costs related to the Eighth Amendment of our Former Credit Agreement, which were recorded in *Net loss on early extinguishment of debt*.

On May 7, 2018, we used the remaining capacity under the Former Credit Agreement from the Eighth Amendment to fund the cash consideration used in our privately-negotiated exchanges of approximately 80% of the then outstanding aggregate principal amount of our Convertible Notes. We recognized (i) a net gain of \$1.2 million related to the acquisition of our Convertible Notes; and (ii) a loss of \$0.5 million related to transaction costs incurred for the acquisition of our Convertible Notes, all of which were recorded in *Net loss on early extinguishment of debt*.

On May 31, 2018, we completed the issuance of \$325.0 million in aggregate principal amount of our Senior Notes.

On May 31, 2018, we used \$291.4 million of the net proceeds from the sale of the Senior Notes to repay all amounts outstanding under our Former Credit Agreement and all commitments thereunder were terminated. In connection with the repayment in full of all amounts due thereunder, the Former Credit Agreement was retired and \$2.0 million of letters of credit previously issued under the Former Credit Agreement were deemed issued under (and remain outstanding under) the New Credit Facility. We did not incur any material early termination penalties in connection with the repayment of the Former Credit Agreement. In connection with the termination of the Former Credit Agreement, we recognized (i) a loss of \$0.7 million related to the Eighth Amendment transaction costs; and (ii) a loss of \$0.9 million of unamortized debt issuance costs related to the Former Credit Agreement, all of which were recorded in *Net loss on early extinguishment of debt*.

On May 31, 2018, in connection with the issuance of the Senior Notes, we entered into a \$150.0 million New Credit Facility with the financial institutions party thereto, as lenders, and Bank of America, N.A., as administrative agent. Our obligations under the New Credit Facility are unconditionally guaranteed on a joint and several basis by the same subsidiaries which guarantee the Senior Notes and certain of our subsequently acquired or organized domestic subsidiaries (collectively, the "Credit Facility Guarantors").

At closing of the New Credit Facility, we had no outstanding borrowings under the New Credit Facility and \$148.0 million of availability after giving effect to the \$2.0 million of letters of credit previously issued under the Former Credit Agreement that were deemed issued under (and remain outstanding under) the New Credit Facility. The New Credit Facility includes an accordion feature allowing for future increases in the facility size by an additional amount of up to \$75.0 million. The New Credit Facility matures on May 31, 2023.

On November 8, 2018, we entered into a first amendment (the "Amendment") to the New Credit Facility. The Amendment (i) modified the definition of "EBITDA" in the New Credit Facility to increase from \$1,000,000 to \$2,000,000 the aggregate amount of severance costs that may be added back to Net Income (as defined in the New Credit Facility) when calculating EBITDA for any period, and (ii) modified the negative covenant restriction on Restricted Payments (as defined in the New Credit Facility) to permit us to acquire or purchase Equity Interests (as defined in the New Credit Facility) subject to the satisfaction of certain conditions and provided that, if before and after giving pro-forma effect to such acquisition or purchase the Total Leverage Ratio (as defined in the New Credit Facility) is (x) equal to or greater than 4.50 to 1.00 but less than or equal to 5.25 to 1.00, then the aggregate amount may not exceed \$30,000,000 during the term of the New Credit Facility, and (y) less than 4.50 to 1.00, then the aggregate amount is unlimited.

We incurred \$1.1 million in transactions costs related to our New Credit Facility, which were capitalized and will be amortized over the remaining term of the related debt using the straight-line method.

The New Credit Facility is secured by a first-priority perfected security interest in and lien on substantially all of our personal property assets and those of the Credit Facility Guarantors, and includes provisions which require us and such subsidiaries, upon

the occurrence of an event of default under the New Credit Facility, to grant additional liens on real property assets accounting for no less than 50% of our and the Credit Facility Guarantors' funeral operations.

The New Credit Facility contains customary affirmative covenants, including, but not limited to, covenants with respect to the use of proceeds, payment of taxes and other obligations, continuation of our business and the maintenance of existing rights and privileges, the maintenance of property and insurance, amongst others.

In addition, the New Credit Facility also contains customary negative covenants, including, but not limited to, covenants that, among other things, restrict (subject to certain exceptions) our ability and the Credit Facility Guarantor's ability to incur indebtedness, grant liens, make investments, engage in acquisitions, mergers or consolidations, and pay dividends and other restricted payments, and the following financial covenants: a total leverage ratio not to exceed 5.50 to 1.00, and a fixed charge coverage ratio of not less than 1.20 to 1.00 as of the end of any period of four consecutive fiscal quarters. We will calculate the financial covenants on a consolidated basis.

As of December 31, 2018, we had outstanding borrowings under the New Credit Facility of \$27.1 million and acquisition indebtedness and capital lease obligations of \$15.4 million. We had one letter of credit issued on November 30, 2018 and outstanding under the New Credit Facility for \$2.0 million, which bears interest at 2.0% and will expire on November 25, 2019. The letter of credit automatically renews annually and secures our obligations under our various self-insured policies. Outstanding borrowings under our New Credit Facility bear interest at either a prime rate or a LIBOR rate, plus an applicable margin based upon our leverage ratio. As of December 31, 2018, the prime rate margin was equivalent to 0.875% and the LIBOR margin was 1.875%. The weighted average interest rate on our New Credit Facility for the six months ended December 31, 2018 was 0.4%. For the six months ended June 30, 2018, the weighted average interest rate on our Former Credit Agreement was 4.0%.

We have no material assets or operations independent of our subsidiaries. All assets and operations are held and conducted by subsidiaries, each of which have fully and unconditionally guaranteed our obligations under the New Credit Facility. Additionally, we do not currently have any significant restrictions on our ability to receive dividends or loans from any New Credit Facility Guarantors.

We were in compliance with the covenants contained in our New Credit Facility as of December 31, 2018, with a leverage ratio of 5.10 to 1.00 and a fixed charge coverage ratio of 1.84 to 1.00.

Acquisition debt consists of deferred purchase price and promissory notes payable to sellers. A majority of the deferred purchase price and notes bear interest at 0% and are discounted at imputed interest rates ranging from 7.3% to 10.0%. Original maturities range from five to twenty years. Imputed interest expense related to our acquisition debt was \$0.5 million, \$0.9 million and \$0.8 million for the years ended December 31, 2016, 2017 and 2018, respectively.

Amortization of debt issuance costs related to our New Credit Facility was \$0.1 million for the year ended December 31, 2018. Amortization of debt issuance costs related to our Former Credit Agreement was \$0.4 million, \$0.3 million and \$0.1 million for the years ended December 31, 2016, 2017 and 2018, respectively.

Convertible Notes

On March 19, 2014, we issued \$143.75 million aggregate principal amount of our Convertible Notes. The Convertible Notes bear interest at 2.75% per year. Interest on the Convertible Notes began to accrue on March 19, 2014 and is payable semi-annually in arrears on March 15 and September 15 of each year.

On May 7, 2018, we completed our Exchange of approximately \$115.0 million in aggregate principal amount of Convertible Notes in privately-negotiated exchange agreements with a limited number of convertible noteholders for \$74.8 million in cash (plus accrued interest of \$0.4 million totaling \$75.2 million) and 2,822,859 newly issued shares of our common stock, par value \$.01 per share, pursuant to a private placement in reliance on Section 4(a)(2) of the Securities Act of 1933, as amended (the "Securities Act"). The cash portion of the exchange consideration was funded from our Former Credit Agreement as amended by the Eighth Amendment. Following the settlement of the Convertible Note exchange, the aggregate principal amount of our Convertible Notes outstanding was reduced to \$28.8 million.

On December 24, 2018, we completed privately-negotiated repurchases of an additional \$22.4 million in aggregate principal amount of Convertible Notes, which represented 78% of the aggregate principal amount of our Convertible Notes then outstanding for \$22.9 million in cash (plus accrued interest of approximately \$0.2 million totaling \$23.0 million). The consideration for the repurchases was funded from our New Credit Facility. Following these repurchases, the aggregate principal amount of our Convertible Notes outstanding was reduced to \$6.3 million.

We recognized a net gain of \$1.7 million, which was recorded in *Net loss on early extinguishment of debt*, related to the May exchanges and the December repurchases of our Convertible Notes. The gain is composed of a difference of \$3.1 million between the fair value and the carrying amount of the liability component of our Convertible Notes immediately preceding each exchange and repurchase, as applicable, partially offset by a write-off of \$1.4 million in unamortized debt issuance costs related

to the exchange and repurchase of our Convertible Notes. The gain does not include the impact of any transaction costs we incurred to exchange or the repurchase the Convertible Notes.

We incurred \$0.9 million in transactions costs related to the exchange and repurchase of our Convertible Notes, of which \$0.6 million was expensed and recorded in *Net loss on early extinguishment of debt* and \$0.3 million was allocated to the equity component and recorded in *Additional paid-in capital*.

The Convertible Notes are general unsecured obligations and are subordinated in the right of payment to all of our existing and future senior indebtedness and equal in right of payment with our other existing and future subordinated indebtedness. The initial conversion rate of the Convertible Notes as of March 19, 2014, was 44.3169 shares of our common stock per \$1,000 principal amount of Convertible Notes, equivalent to an initial conversion price of \$22.56 per share of common stock. The conversion rate is subject to adjustment upon the occurrence of certain events, as described in the indenture governing the Convertible Notes. During 2017, an adjustment to the conversion rate of the Convertible Notes was triggered when our Board increased the dividends declared per common share from \$0.05 per share to \$0.075 per share. At December 31, 2018, the adjusted conversion rate of the Convertible Notes was 45.0228 shares of our common stock per \$1,000 principal amount of Convertible Notes, equivalent to an adjusted conversion price of \$22.21 per share of common stock.

At December 31, 2018, the carrying amount of the equity component was \$0.8 million, the principal amount of the liability component was \$6.3 million and the net carrying amount was \$5.7 million. The remaining unamortized debt discount and the remaining unamortized debt issuance costs are being amortized using the effective interest method over the remaining term of approximately 26 months of the Convertible Notes. The effective interest rate on the unamortized debt discount for the years ended December 31, 2017 and 2018 was 11.3% and 11.4%, respectively. The effective interest rate on the unamortized discount and the debt issuance costs for both years ended December 31, 2017 and 2018 was 3.2%.

Interest expense on the Convertible Notes included contractual coupon interest expense of \$4.0 million, \$4.0 million and \$1.9 million for the years ended December 31, 2016, 2017 and 2018, respectively. Accretion of the discount on the Convertible Notes was \$3.9 million, \$4.3 million and \$2.2 million for the years ended December 31, 2016, 2017 and 2018, respectively. Amortization of debt issuance costs related to our Convertible Notes was \$0.5 million, \$0.5 million and \$0.2 million for the years ended December 31, 2016, 2017 and 2018, respectively.

Senior Notes

On May 31, 2018, we completed the issuance of \$325.0 million in aggregate principal amount of our Senior Notes and related guarantees in a private offering under Rule 144A and Regulation S under the Securities Act.

We received proceeds of \$320.1 million, net of a 1.5% debt discount of \$4.9 million, of which we used \$291.4 million to repay our existing indebtedness under our Former Credit Agreement and intend to use the remaining net proceeds for general corporate purposes, including acquisitions. We incurred \$1.4 million in transaction costs related to the Senior Notes.

The Senior Notes were issued under an indenture, dated as of May 31, 2018 (the “Indenture”), among us, certain of our existing subsidiaries (collectively, the “Subsidiary Guarantors”), as guarantors, and Wilmington Trust, National Association., as trustee.

The Senior Notes bear interest at 6.625% per year. Interest on the Senior Notes began to accrue on May 31, 2018 and is payable semi-annually in arrears on September 1 and December 1 of each year, beginning on December 1, 2018 to holders of record on each May 15 and November 15 preceding an interest payment date. The Senior Notes mature on June 1, 2026, unless earlier redeemed or repurchased. The Senior Notes are unsecured, senior obligations and are fully and unconditionally guaranteed on a senior unsecured basis, jointly and severally, by each of the Subsidiary Guarantors.

We may redeem all or part of the Senior Notes at any time prior to June 1, 2021 at a redemption price equal to 100% of the principal amount of Senior Notes redeemed, plus a “make whole” premium, and accrued and unpaid interest, if any, to the date of redemption. We have the right to redeem the Senior Notes at any time on or after June 1, 2021 at the redemption prices described in the Indenture, plus accrued and unpaid interest, if any, to the date of redemption. Additionally, at any time before June 1, 2021, we may redeem up to 40% of the aggregate principal amount of the Senior Notes issued with an amount equal to the net proceeds of certain equity offerings, at a price equal to 106.625% of the principal amount of the Senior Notes, plus accrued and unpaid interest, if any, to the date of redemption; provided that (1) at least 60% of the aggregate principal amount of the Senior Notes (including any additional Senior Notes) originally issued under the Indenture remain outstanding immediately after the occurrence of such redemption (excluding Senior Notes held by us); and (2) each such redemption must occur within 180 days of the date of the closing of each such equity offering.

If a “change of control” occurs, holders of the Senior Notes will have the option to require us to purchase for cash all or a portion of their Senior Notes at a price equal to 101% of the principal amount of the Senior Notes, plus accrued and unpaid interest. In addition, if we make certain asset sales and do not reinvest the proceeds thereof or use such proceeds to repay certain debt, we

will be required to use the proceeds of such asset sales to make an offer to purchase the Senior Notes at a price equal to 100% of the principal amount of the Senior Notes, plus accrued and unpaid interest.

The Indenture contains restrictive covenants limiting our ability and our Restricted Subsidiaries (as defined in the Indenture) to, among other things, incur additional indebtedness or issue certain preferred shares, create liens on certain assets to secure debt, pay dividends or make other equity distributions, purchase or redeem capital stock, make certain investments, sell assets, agree to certain restrictions on the ability of Restricted Subsidiaries to make payments to us, consolidate, merge, sell or otherwise dispose of all or substantially all assets, or engage in transactions with affiliates. The Indenture also contains customary events of default.

The debt discount of \$4.9 million and the debt issuance costs of \$1.4 million are being amortized using the effective interest method over the remaining term of approximately 89 months of the Senior Notes. The effective interest rate on the unamortized debt discount and the unamortized debt issuance costs for year ended December 31, 2018 was 6.87% and 6.69%, respectively.

Interest expense on the Senior Notes included contractual coupon interest expense of \$12.6 million for the year ended December 31, 2018. Amortization of the debt discount on the Senior Notes was \$0.3 million for the year ended December 31, 2018 and amortization of debt issuance costs on the Senior Notes was \$0.1 million for the year ended December 31, 2018.

CONTRACTUAL OBLIGATIONS

The following table summarizes the known future payments required for the debt on our Consolidated Balance Sheet as of December 31, 2018. Where appropriate we have indicated the footnote in Part II, Item 8, Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements where additional information is available.

	Financial Note Reference	Payments Due By Period (in millions)						
		Total	2019	2020	2021	2022	2023	After 5 Years
Long-term debt obligations	14	\$ 36.0	\$ 2.0	\$ 1.3	\$ 1.0	\$ 0.6	\$ 27.7	\$ 3.4
Interest obligation on long-term debt ^(a)	14	5.9	1.2	1.0	0.9	0.8	0.4	1.6
Capital lease obligations, including interest	17	11.3	0.9	0.8	0.8	0.8	0.9	7.1
Senior Notes ^(b)	16	325.0	—	—	—	—	—	325.0
Convertible Notes ^(c)	15	6.3	—	—	6.3	—	—	—
Interest on Senior Notes	16	159.7	21.5	21.5	21.6	21.6	21.5	52.0
Interest on Convertible Notes	15	0.4	0.2	0.2	—	—	—	—
Operating lease obligations	17	11.5	3.7	3.2	2.7	0.5	0.3	1.1
Total contractual obligations		<u>\$ 556.1</u>	<u>\$ 29.5</u>	<u>\$ 28.0</u>	<u>\$ 33.3</u>	<u>\$ 24.3</u>	<u>\$ 50.8</u>	<u>\$ 390.2</u>

(a) Based on interest rates in effect at December 31, 2018.

(b) Matures in 2026.

(c) Matures in 2021.

OFF-BALANCE SHEET ARRANGEMENTS

The following table summarizes our off-balance sheet arrangements as of December 31, 2018. Where appropriate, we have indicated the footnote in Part II, Item 8, Financial Statements and Supplementary Data, Notes to the Consolidated Financial Statements where additional information is available. We have various non-compete agreements with former owners and employees of businesses we have acquired. These agreements are generally for one to ten years and provide for periodic payments over the term of the agreements. We have various consulting agreements with former owners of businesses we have acquired. Payments for such agreements are generally not made in advance. These agreements are generally for one to five years and provide for bi-weekly or monthly payments. We have employment agreements with certain of our executive officers and senior leadership. These agreements are generally for three to five years and provide for participation in various incentive compensation arrangements. These agreements generally renew automatically on an annual basis after their initial term has expired.

	Financial Note Reference	Payments Due By Period (in millions)						
		Total	2019	2020	2021	2022	2023	After 5 Years
Non-compete agreements	17	\$ 8.1	\$ 1.9	\$ 1.6	\$ 1.5	\$ 1.1	\$ 0.7	\$ 1.3
Consulting agreements	17	2.8	0.9	0.7	0.6	0.4	0.2	—
Employment agreements ^(a)	17	5.7	1.9	1.2	0.9	0.8	0.7	0.2
Total contractual cash obligations		<u>\$ 16.6</u>	<u>\$ 4.7</u>	<u>\$ 3.5</u>	<u>\$ 3.0</u>	<u>\$ 2.3</u>	<u>\$ 1.6</u>	<u>\$ 1.5</u>

(a) Melvin C. Payne, our Chairman of the Board and Chief Executive Officer, has an employment agreement that does not renew after the initial term of five years.

The obligations related to our off-balance sheet arrangements are significant to our future liquidity; however, although we can provide no assurances, we anticipate that these obligations will be funded from cash provided from our operating activities. If we are not able to meet these obligations with cash provided by our operating activities, we may be required to access the capital markets or draw down on our New Credit Facility, both of which may be more difficult to access.

FINANCIAL HIGHLIGHTS

	Year Ended December 31,		
	2016	2017	2018
Revenue	\$ 248,200	\$ 258,139	\$ 267,992
Funeral contracts	33,160	34,894	36,816
Average revenue per contract	\$ 5,642	\$ 5,705	\$ 5,674
Preneed interment rights (property) sold	7,606	6,959	7,063
Average price per interment right sold	\$ 3,172	\$ 3,294	\$ 3,472
Gross profit	\$ 79,650	\$ 76,799	\$ 75,947
Net income	\$ 19,581	\$ 37,193	\$ 11,645

Revenue for the year increased \$9.9 million in 2018 compared to 2017, as we experienced a 5.5% increase in total funeral contracts, offset by a slight decrease in the average revenue per funeral contract of 0.5%. In addition, the average price per interment right (property) sold increased 5.4% and we experienced an increase of 1.5% in the number of preneed interment rights sold.

Revenue for the year increased \$9.9 million in 2017 compared to 2016, as we experienced a 5.2% increase in total funeral contracts and an increase in the average revenue per funeral contract of 1.1%. In addition, while we experienced a decrease of 8.5% in the number of preneed interment rights sold, the average price per interment right sold increased 3.8%. Further discussion of Revenue for our funeral home and cemetery segments is presented herein under “– Results of Operations.”

Gross profit decreased \$0.9 million in 2018 compared to 2017, primarily due to a decline in revenue from our funeral home segment and higher salaries and benefits costs (including higher health care costs) across all businesses.

Gross profit decreased \$2.9 million in 2017 compared to 2016 primarily due to a decline in preneed cemetery revenue, higher insurance costs and higher costs as a percentage of revenue in the six businesses we acquired in 2016. Further discussion of the components of Gross profit for our funeral home and cemetery segments, is presented herein under “– Results of Operations.”

Net income in 2018 decreased \$25.5 million compared to 2017 primarily due to a \$17.5 million discrete tax benefit recorded due to the re-measurement of our deferred tax assets and liabilities to reflect the impact of the recent tax law change. Additionally, we experienced an increase of \$8.2 million in interest expense related to our Senior Notes.

Net income in 2017 increased \$17.6 million compared to 2016 primarily due to the \$17.5 million discrete tax benefit. Further discussion of General, administrative and other expenses, Home office depreciation and amortization expense, Interest expense, Income taxes and other components of income and expenses are presented herein under “– Other Financial Statement Items.”

REPORTING AND NON-GAAP FINANCIAL MEASURES

We also present our financial performance in our “Operating and Financial Trend Report” (“Trend Report”) as reported in our earnings release for the year ending December 31, 2018 dated February 20, 2019 and discussed in the corresponding earnings conference call. This Trend Report is used as a supplemental financial measurement statement by management and investors to compare our current financial performance with our previous results and with the performance of other companies. We do not intend for this information to be considered in isolation or as a substitute for other measures of performance prepared in accordance with United States generally accepted accounting principles (“GAAP”). The Trend Report is a non-GAAP statement that also provides insight into underlying trends in our business.

Below is a reconciliation of Net Income (a GAAP measure) to Adjusted Net Income (a non-GAAP measure) for the years ended December 31, 2016, 2017, and 2018 (in thousands):

	<u>2016</u>	<u>2017</u>	<u>2018</u>
Net income	\$ 19,581	\$ 37,193	\$ 11,645
Special items, net of tax except for items noted by**(1)			
Acquisition and divestiture expenses	456	—	—
Severance and retirement costs	2,587	—	1,134
Performance Awards cancellation write-off	—	—	2,594
Consulting fees	323	—	—
Accretion of discount on Convertible Notes**	3,870	4,329	2,192
Net Loss on early extinguishment of debt	369	—	397
Loss on sale of business and other costs	1,152	—	439
Goodwill and other impairments	—	—	805
Litigation reserve	—	—	790
Natural disaster costs	—	403	345
Tax adjustment related to certain discrete items**	—	(17,176)	1,225
Adjusted net income ⁽²⁾	<u>\$ 28,338</u>	<u>\$ 24,749</u>	<u>\$ 21,566</u>

(1) Special items are defined as charges or credits included in our GAAP financial statements that can vary from period to period and are not reflective of costs incurred in the ordinary course of our operations. Special Items are taxed at the federal statutory rate of 35 percent for both years ended December 31, 2016 and 2017 and 21 percent for the year ended December 31, 2018 except for the Accretion of the discount on the Convertible Notes and the Tax adjustment related to certain discrete items, as these are non-tax deductible items.

(2) Adjusted net income is defined as Net income plus adjustments for Special items and other expenses or gains that we believe do not directly reflect our core operations and may not be indicative of our normal business operations.

Below is a reconciliation of Gross profit (a GAAP measure) to Operating profit (a non-GAAP measure) for the years ended December 31, 2016, 2017, and 2018 (in thousands):

	<u>2016</u>	<u>2017</u>	<u>2018</u>
Gross profit	\$ 79,650	\$ 76,799	\$ 75,947
Cemetery property amortization	3,904	3,350	3,602
Field depreciation expense	10,015	11,024	12,015
Regional and unallocated funeral and cemetery costs	10,844	13,339	12,749
Operating profit ⁽¹⁾	<u>\$ 104,413</u>	<u>\$ 104,512</u>	<u>\$ 104,313</u>

(1) Operating profit is defined as Gross profit less Cemetery property amortization, Field depreciation expense and Regional and unallocated funeral and cemetery costs.

Our operations are reported in two business segments: Funeral Home and Cemetery. Below is a breakdown of Operating profit (a non-GAAP measure) by Segment for the years ended December 31, 2016, 2017, and 2018 (in thousands):

	<u>2016</u>	<u>2017</u>	<u>2018</u>
Funeral Home	\$ 79,183	\$ 81,981	\$ 82,154
Cemetery	25,230	22,531	22,159
Operating profit	<u>\$ 104,413</u>	<u>\$ 104,512</u>	<u>\$ 104,313</u>
Operating profit margin ⁽¹⁾	42.1%	40.5%	38.9%

(1) Operating profit margin is defined as Operating profit as a percentage of Revenue.

Further discussion of Operating profit for our funeral home and cemetery segments is presented herein under “– Results of Operations.”

YEAR ENDED DECEMBER 31, 2018 COMPARED TO YEAR ENDED DECEMBER 31, 2017

Results of Operations

The following is a discussion of our results of operations for the years ended December 31, 2018 and 2017. The term “same store” refers to funeral homes and cemeteries acquired prior to January 1, 2014 and owned and operated for the entirety of each period being presented. Funeral homes and cemeteries purchased after December 31, 2013 are referred to as “acquired.” This classification of acquisitions has been important to management and investors in monitoring the results of these businesses and to gauge the leveraging performance contribution that a selective acquisition program can have on total company performance. The term “divested” when discussed in the Funeral Home Segment, refers to one business sold during 2017. The term “divested” when discussed in the Cemetery Segment, refers to three cemetery businesses that we ceased to operate on September 30, 2018, as a result of an expired management agreement. Cemetery property amortization, Field depreciation expense and Regional and unallocated funeral and cemetery costs, are not included in Operating profit, a non-GAAP financial measure. Adding back these items will result in Gross profit, a GAAP financial measure.

Funeral Home Segment. The following table sets forth certain information regarding our Revenue and Operating profit from our funeral home operations for the year ended December 31, 2018 compared to the years ended December 31, 2017 (in thousands):

	<u>Year Ended December 31,</u>	
	<u>2017</u>	<u>2018</u>
Revenue:		
Same store operating revenue	\$ 161,690	\$ 160,459
Acquired operating revenue	30,108	41,447
Divested revenue	606	—
Preneed funeral insurance commissions	1,254	1,294
Preneed funeral trust earnings	7,228	7,525
Total	<u>\$ 200,886</u>	<u>\$ 210,725</u>
Operating profit:		
Same store operating profit	\$ 62,361	\$ 58,976
Acquired operating profit	11,770	15,397
Divested operating profit (loss)	302	(3)
Preneed funeral insurance commissions	436	415
Preneed funeral trust earnings	7,112	7,369
Total	<u>\$ 81,981</u>	<u>\$ 82,154</u>

The following measures reflect the significant metrics over this comparative period:

	<u>Year Ended December 31,</u>	
	<u>2017</u>	<u>2018</u>
Same store:		
Contract volume	30,162	30,088
Average revenue per contract, excluding preneed funeral trust earnings	\$ 5,361	\$ 5,333
Average revenue per contract, including preneed funeral trust earnings	\$ 5,559	\$ 5,542
Burial rate	40.6%	39.6%
Cremation rate	52.2%	52.9%
Acquired:		
Contract volume	4,680	6,728
Average revenue per contract, excluding preneed funeral trust earnings	\$ 6,433	\$ 6,160
Average revenue per contract, including preneed funeral trust earnings	\$ 6,581	\$ 6,265
Burial rate	44.7%	42.5%
Cremation rate	46.5%	49.2%

Funeral home same store operating revenue for the year ended December 31, 2018 decreased \$1.2 million, primarily due to the slight decrease in both the same store contract volumes and the average revenue per contract compared to year ended December 31, 2017.

Same store operating profit for the year ended December 31, 2018 decreased \$3.4 million when compared to the year ended December 31, 2017 and the comparable operating profit margin decreased 180 basis points to 36.8%. The decrease is primarily due to the decrease in same store revenue, as well as an increase in operating expenses of \$2.1 million, mostly related to salaries and benefits expenses.

Funeral home acquired operating revenue for the year ended December 31, 2018 increased \$11.3 million, as our funeral home acquired portfolio for the year ended December 31, 2018 includes seven businesses acquired in the fourth quarter of 2017, and four businesses in the third quarter of 2018 not fully present in the year ended December 31, 2017. The decrease in acquired average revenue per contract is primarily due to an increase in the acquired cremation rate and a decrease in the acquired average revenue per cremation contract.

Acquired operating profit for the year ended December 31, 2018 increased \$3.6 million when compared to the year ended December 31, 2017. Although operating profit increased, operating profit margin decreased by 200 basis points to 37.1% for the year ended December 31, 2018 compared to the same period in 2017. The decrease is primarily due to the seven businesses we acquired in the fourth quarter of 2017, as operating profit margins for these acquired businesses were lower compared to our other acquired businesses, particularly with regard to higher salaries and benefits expenses.

Preneed funeral insurance commissions and preneed funeral trust earnings, which are recorded in *Other revenue*, on a combined basis, increased \$0.3 million for the year ended December 31, 2018 compared to the same period in 2017 due to an increase in earnings from the maturity of preneed contracts. Operating profit for preneed funeral insurance commissions and preneed funeral trust earnings, on a combined basis, increased \$0.2 million for the year ended December 31, 2018 compared to the same period in 2017 primarily due to the increase in revenue, offset by an increase in commission and preneed selling expenses.

Cemetery Segment. The following table sets forth certain information regarding our Revenue and Operating profit from our cemetery operations for the year ended December 31, 2017 compared to the year ended December 31, 2018 (in thousands):

	Year Ended December 31,	
	2017	2018
Revenue:		
Same store operating revenue	\$ 40,047	\$ 41,740
Acquired operating revenue	3,195	3,395
Divested revenue	6,173	4,712
Preneed cemetery trust earnings	6,300	5,761
Preneed cemetery finance charges	1,538	1,659
Total	<u>\$ 57,253</u>	<u>\$ 57,267</u>
Operating profit:		
Same store operating profit	\$ 12,368	\$ 12,733
Acquired operating profit	1,038	1,147
Divested operating profit	1,675	1,376
Preneed cemetery trust earnings	5,912	5,244
Preneed cemetery finance charges	1,538	1,659
Total	<u>\$ 22,531</u>	<u>\$ 22,159</u>

The following measures reflect the significant metrics over this comparative period:

	Year Ended December 31,	
	2017	2018
Same store:		
Preneed revenue as a percentage of operating revenue	57%	58%
Preneed revenue	\$ 22,608	\$ 24,374
Number of preneed interment rights sold	5,673	5,991
Atneed revenue	\$ 17,439	\$ 17,366
Acquired:		
Preneed revenue as a percentage of operating revenue	65%	60%
Preneed revenue	\$ 2,076	\$ 2,034
Number of preneed interment rights sold	523	484
Atneed revenue	\$ 1,119	\$ 1,361

Cemetery same store operating revenue for the year ended December 31, 2018 increased \$1.7 million, as we experienced a 5.6% increase in the number of preneed interment rights sold and a 4.4% increase in the average price of interments sold for the year ended December 31, 2018 compared to the same period in 2017. In early 2018, we invested in additional leadership at certain businesses which contributed to the increase in revenue. In addition, we recognized revenue from the completion of large gardens at two of our cemeteries. Same store atneed revenue, which represents approximately 42% of our same store operating revenue decreased \$0.1 million, as we experienced a 4.2% decrease in the number of atneed contracts, offset by a 3.9% increase in the average sale per contract.

Cemetery same store operating profit for the year ended December 31, 2018 increased \$0.4 million from the same period in 2017 primarily due to the \$1.8 million increase in preneed revenue, offset by increases in certain expenses. The expense categories with the largest increases include \$0.7 million of facilities and grounds expenses, \$0.6 million of salaries and benefits and \$0.2 million of property tax expense. The comparable operating profit margin decreased to 30.5% for the year ended December 31, 2018 from 30.9% in the same period in 2017.

Cemetery acquired operating profit margin increased to 33.8% for the year ended December 31, 2018 from 32.5% in the same period in 2017. The increase in operating margin is primarily due to the \$0.2 million increase in cemetery acquired revenue coupled with effective cost management.

Preneed cemetery trust earnings and preneed cemetery finance charges, which are recorded in *Other revenue*, on a combined basis, decreased \$0.4 million for the year ended December 31, 2018 compared to the same period in 2017, primarily due to market fluctuations in the fourth quarter of 2018 which caused the revenue in our perpetual care trust to decline by \$0.5 million.

Cemetery property amortization. Cemetery property amortization totaled \$3.6 million for year the ended December 31, 2018, an increase of \$0.3 million compared to the year ended December 31, 2017. The increase was primarily attributable to additional sales of cemetery property in 2018 compared to 2017.

Field depreciation. Depreciation expense for our field businesses totaled \$12.0 million for year the ended December 31, 2018, an increase of \$1.0 million compared to the year ended December 31, 2017. The increase was primarily attributable to additional depreciation expense from assets acquired in our 2017 and 2018 acquisitions.

Regional and unallocated funeral and cemetery costs. Regional and unallocated funeral and cemetery costs consist of salaries and benefits for regional management, field incentive compensation and other related costs for field infrastructure. Regional and unallocated funeral and cemetery costs totaled \$12.7 million for the year ended December 31, 2018, a decrease of \$0.6 million primarily due to a decrease of \$0.9 million in other general administrative costs, offset by a \$0.2 million increase in severance costs, and a \$0.1 million increase in salaries and benefits.

Other Financial Statement Items

General, administrative and other. General, administrative and other expenses totaled \$30.8 million for the year ended December 31, 2018, an increase of \$4.6 million compared to the year ended December 31, 2017. The increase was attributable to a \$3.4 million increase in incentive and equity compensation related to the cancellation of performance awards in 2018, a \$1.0 million increase in litigation reserves, a \$0.9 million increase in severance costs, a \$0.3 million increase in group health insurance, offset by a \$0.1 million decrease in acquisition costs, a \$0.2 million decrease in salaries and benefits, a \$0.4 million decrease in public company costs, and \$0.3 million decrease in other general administrative costs.

Home office depreciation and amortization. Home office depreciation and amortization expense totaled \$1.8 million for the year ended December 31, 2018, an increase of \$0.2 million compared to the year ended December 31, 2017. The increase was primarily attributable to additional depreciation expense from assets related to our IT infrastructure.

Interest expense. Interest expense was \$21.1 million for the year ended December 31, 2018 compared to \$12.9 million for the year ended December 31, 2017, an increase of \$8.2 million due to the following: (i) an increase of \$12.9 million related to our Senior Notes; offset by (ii) a decrease of \$2.6 million related to our Former Credit Agreement; and (ii) a decrease of \$2.1 million related to the Exchange of our Convertibles Notes.

Accretion of discount on convertible notes. For the year ended December 31, 2018, we recognized accretion of the discount on our Convertible Notes of \$2.2 million compared to \$4.3 million for the same period in 2017, a decrease of \$2.1 million, which was attributable to the Exchange of our Convertible Notes.

Net loss on early extinguishment of debt. For the year ended December 31, 2018, we recognized a net loss of \$0.5 million on the early extinguishment of debt for the following transactions:

(i) a loss of \$1.6 million related to the termination of our Former Credit Agreement, which consisted of a write-off of \$0.7 million of transaction costs related to the Eighth Amendment and a write-off of \$0.9 million of unamortized debt issuance costs related to the Former Credit Agreement;

(ii) a net gain of \$1.7 million related to the May exchanges and the December repurchases of our Convertible Notes, which consisted of a gain of \$3.1 million on the difference between the fair value and the carrying amount of the liability component of our Convertible Notes immediately preceding each exchange and repurchase, and a loss of \$1.4 million related to the write-off of unamortized debt issuance costs due to the exchange and repurchase of our Convertible Notes; and

(iii) a loss of \$0.6 million related to transaction costs incurred for the exchange and repurchase of our Convertible Notes.

Other, net. For the year ended December 31, 2018, Other, net costs were \$1.2 million related to the following transactions: (i) an impairment of \$0.8 million related to a funeral home business that we intend to cease operating in 2019; (ii) a \$0.3 million loss related to an expired cemetery management agreement; (iii) an impairment of \$0.2 million related to the real property of a funeral home business held for sale; and offset by (iv) \$0.1 million in refunds received for the reimbursement of expenses related to divested businesses.

Income taxes. Our income tax provision was \$6.6 million for the year ended December 31, 2018 compared to our income tax benefit of \$4.4 million for the year ended December 31, 2017. Our tax rate, before discrete items was 31.5% and 40.0% for the years ended December 31, 2018 and 2017, respectively. We recorded discrete tax expense of \$0.8 million of which \$1.2 million was recorded under ASU 2016-09, as a result of the cancellation of Performance Award Agreements. A discrete tax benefit of \$0.5

million was recorded as a result of return to provision adjustments that adjusted the previously re-measured deferred tax assets and/or liabilities.

Our operating effective tax rate primarily increased as a result of the cancellation of the Performance Award Agreements due to the impact the additional expense had on our state tax provision. We file both consolidated and separate entity state returns. The expenses recorded for the cancellation of the Performance Award Agreements were recorded in an entity that is included in our consolidated filings, but no expenses were allocable to the entities where we file on a separate entity basis. Thus, the state provision in the separate entity states is higher relative to the state provision where we file on a consolidated basis. The increase in our effective tax rate attributable to this occurrence represents 2.7% of the total effective tax rate. An additional contributing factor was pre-tax book income (“PTBI”) was lower in 2018 compared to 2017, as such, as PTBI decreases, the percentage impact of the permanent adjustments on the effective tax rate increases resulting in a higher effective tax rate. At December 31, 2018, no uncertain tax positions were identified.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 18 for additional information regarding our income taxes.

YEAR ENDED DECEMBER 31, 2017 COMPARED TO YEAR ENDED DECEMBER 31, 2016

Results of Operations

The following is a discussion of our results of operations for the years ended December 31, 2017 and 2016. The term “same store” refers to funeral homes and cemeteries acquired prior to January 1, 2013 and owned and operated for the entirety of each period being presented. Funeral homes and cemeteries purchased after December 31, 2012 are referred to as “acquired.” This classification of acquisitions has been important to management and investors in monitoring the results of these businesses and to gauge the leveraging performance contribution that a selective acquisition program can have on total company performance. Cemetery property amortization, Field depreciation expense and Regional and unallocated funeral and cemetery costs, are not included in Operating profit, a non-GAAP financial measure. Adding back these items will result in Gross profit, a GAAP financial measure.

Funeral Home Segment. The following table sets forth certain information regarding our Revenue and Operating profit from our funeral home operations for the year ended December 31, 2016 compared to the year ended December 31, 2017 (in thousands):

	Year Ended December 31,	
	2016	2017
Revenue:		
Same store operating revenue	\$ 155,710	\$ 158,106
Acquired operating revenue	24,914	34,294
Preneed funeral insurance commissions	1,429	1,254
Preneed funeral trust earnings	7,348	7,232
Total	<u>\$ 189,401</u>	<u>\$ 200,886</u>
Operating profit:		
Same store operating profit	\$ 60,823	\$ 60,864
Acquired operating profit	10,419	13,565
Preneed funeral insurance commissions	682	436
Preneed funeral trust earnings	7,259	7,116
Total	<u>\$ 79,183</u>	<u>\$ 81,981</u>

The following measures reflect the significant metrics over this comparative period:

	<u>Year Ended December 31,</u>	
	<u>2016</u>	<u>2017</u>
Same store:		
Contract volume	29,274	29,587
Average revenue per contract, excluding preneed funeral trust earnings	\$ 5,319	\$ 5,344
Average revenue per contract, including preneed funeral trust earnings	\$ 5,512	\$ 5,535
Burial rate	41.2%	40.3%
Cremation rate	51.5%	52.5%
Acquired:		
Contract volume	3,886	5,307
Average revenue per contract, excluding preneed funeral trust earnings	\$ 6,411	\$ 6,462
Average revenue per contract, including preneed funeral trust earnings	\$ 6,628	\$ 6,654
Burial rate	46.9%	46.5%
Cremation rate	44.7%	45.1%

Funeral home same store operating revenue for the year ended December 31, 2017 increased \$2.4 million, primarily due to a slight increase in both the same store contract volumes and the average revenue per contract compared to the year ended December 31, 2016.

Same store operating profit for the year ended December 31, 2017 remained flat at \$60.9 million when compared to the year ended December 31, 2016, despite the increase in operating revenue. Same store operating margin decreased 60 basis points to 38.5% for the year ended December 31, 2017 as we focused on hiring additional Managing Partners to increase market share and grow revenue in our same store businesses. In 2017, we began a process of de-clustering businesses in certain markets by adding Managing Partners to a business that may have been grouped with two or more businesses led by a single Managing Partner. While this results in shorter-term higher salaries and benefits, we believe that having the right Managing Partners in these businesses will increase market share and grow same store revenue. Same store salaries and benefits for the year ended December 31, 2017 increased \$1.4 million when compared to same period in 2016. Additionally, general liability and other insurance related expenses increased \$0.6 million for the year ended December 31, 2017 over the same period in 2016.

Funeral home acquired operating revenue for the year ended December 31, 2017 increased \$9.4 million, as our funeral home acquired portfolio for the year ended December 31, 2017, includes six businesses acquired during the second half of 2016, not fully present in the year ended December 31, 2016. Additionally, we acquired seven businesses in the fourth quarter of 2017. Our 2016 and 2017 acquired businesses accounted for approximately 90% of the total increase in acquired revenue and volume for the year ended December 31, 2017.

Acquired operating profit for the year ended December 31, 2017 increased \$3.1 million, from the year ended December 31, 2016, primarily due to the six businesses acquired during 2016, not fully present in the year ended December 31, 2016. Although revenue increased, operating profit margin decreased 220 basis points to 39.6% for the year ending December 31, 2017 compared to the same period in 2016. The decrease is primarily due to the businesses acquired in 2016, as salaries and benefits for newly acquired businesses are generally higher as a percentage of revenue than same store businesses. As these acquired businesses become fully integrated into our Being the Best Standards Operating Model, we expect to see their operating profit margins rise.

Preneed funeral insurance commissions and preneed funeral trust earnings, which are recorded in *Other revenue*, on a combined basis, decreased by \$0.3 million compared to the same period in 2016 due to a decrease in earnings from the maturity of preneed contracts, as well as a decrease in preneed insurance contracts sold for which we earn a commission. Operating profit for preneed funeral insurance commissions and preneed funeral trust earnings, on a combined basis, decreased \$0.4 million for the year ended December 31, 2017 compared to the same period in 2016 due to the decrease in revenue, along with an increase in commission and preneed selling expenses.

Cemetery Segment. The following table sets forth certain information regarding our Revenue and Operating profit from our cemetery operations for the year ended December 31, 2016 compared to the year ended December 31, 2017 (in thousands):

	Year Ended December 31,	
	2016	2017
Revenue:		
Same store operating revenue	\$ 45,893	\$ 45,044
Acquired operating revenue	3,054	3,194
Preneed cemetery trust earnings	8,004	7,193
Preneed cemetery finance charges	1,848	1,822
Total	<u>\$ 58,799</u>	<u>\$ 57,253</u>
Operating profit:		
Same store operating profit	\$ 14,613	\$ 12,864
Acquired operating profit	1,054	1,039
Preneed cemetery trust earnings	7,715	6,806
Preneed cemetery finance charges	1,848	1,822
Total	<u>\$ 25,230</u>	<u>\$ 22,531</u>

The following measures reflect the significant metrics over this comparative period:

	Year Ended December 31,	
	2016	2017
Same store:		
Preneed revenue as a percentage of operating revenue	60%	55%
Preneed revenue	\$ 27,316	\$ 24,960
Number of preneed interment rights sold	7,074	6,436
Atneed revenue	\$ 18,577	\$ 20,084
Acquired:		
Preneed revenue as a percentage of operating revenue	66%	65%
Preneed revenue	\$ 2,013	\$ 2,073
Number of preneed interment rights sold	532	523
Atneed revenue	\$ 1,041	\$ 1,121

Cemetery same store operating revenue for the year ended December 31, 2017 decreased \$0.8 million, as we experienced a 9.0% decrease in the number of preneed interment rights sold compared to the same period in 2016. The decrease was primarily a result of the attrition of key sales personnel at certain businesses during the period. In addition, preneed sales were negatively impacted in our Texas and Florida businesses due to the hurricanes affecting those areas in the third quarter of 2017, as well as the absence of \$0.5 million of large cemetery property sales we had in 2016. Same store atneed revenue, which represents approximately 45% of our same store operating revenue, increased \$1.5 million, as we experienced a 10.1% increase in the average sale per contract.

Cemetery same store operating profit for the year ended December 31, 2017 decreased \$1.7 million from the same period in 2016 and the comparable cemetery operating profit margin decreased to 28.6% for the year ended December 31, 2017 from 31.8% in the same period in 2016. The decrease in operating profit was primarily a result of the decrease in revenue, combined with significant increases in certain expenses, including \$0.3 million of facilities and grounds expenses, \$0.3 million of salaries and benefits and \$0.3 million of general liability and other insurance related expenses.

Cemetery acquired operating profit margin decreased to 32.5% for the year ended December 31, 2017 from 34.5% in the same period in 2016, despite a \$0.1 million increase in acquired revenue, as we experienced increases in salaries and benefits and bad debt expense.

Preneed cemetery trust earnings and preneed cemetery finance charges, which are recorded in *Other revenue*, on a combined basis, decreased \$0.8 million for the year ended December 31, 2018 compared to the same period in 2017. The decrease is primarily due to lower interest revenue and capital gains from our perpetual care trust for the year ended December 31, 2017 compared to

the same period in 2016. Revenue earned from finance charges on the preneed contracts remained flat at \$1.8 million for the year ended December 31, 2017 compared to the same period in 2016.

Cemetery property amortization. Cemetery property amortization totaled \$3.4 million for year the ended December 31, 2017, a decrease of \$0.6 million compared to the year ended December 31, 2016. The decrease was primarily attributable to the decrease in sales of cemetery property in 2017 compared to 2016.

Field depreciation. Depreciation expense for our field businesses totaled \$11.0 million for year the ended December 31, 2017, an increase of \$1.0 million compared to the year ended December 31, 2016. The increase was primarily attributable to additional depreciation expense from assets acquired in our 2016 acquisitions, as well as from our newly constructed funeral homes which began operating in the 2017.

Regional and unallocated funeral and cemetery costs. Regional and unallocated funeral and cemetery costs consist of salaries and benefits for regional management, field incentive compensation and other related costs for field infrastructure. Regional and unallocated funeral and cemetery costs totaled \$13.3 million for the year ended December 31, 2017, an increase of \$2.5 million primarily due to a \$1.2 million increase in field incentive compensation, a \$0.6 million increase in natural disaster related costs, a \$0.5 million increase in other general administrative costs and a \$0.2 million increase in salaries and benefits.

On Friday, August 25, 2017 and Sunday, September 10, 2017, hurricanes Harvey and Irma struck Texas and Florida, respectively, which impacted thirteen of our funeral homes and six of our cemeteries. For the year ended December 31, 2017, we spent \$0.9 million for employee assistance and property repair costs, of which we recognized \$0.6 million in expenses and received \$0.3 million in insurance proceeds.

Other Financial Statement Items

General, administrative and other. General, administrative and other expenses totaled \$26.3 million for the year ended December 31, 2017, a decrease of \$1.7 million compared to the year ended December 31, 2016. The decrease was attributable to a \$3.5 million decrease in retirement expenses primarily related to the retirement of two former executives during 2016, a \$0.7 million decrease in acquisition costs, offset by a \$1.1 million increase in salaries and benefits for leadership investments in our Houston support home office, a \$0.7 million increase in public company, regulatory and legal costs related to tax planning, filing our current shelf registration statement and adopting a new long-term incentive plan, a \$0.4 million increase in other general administrative costs and a \$0.3 million increase in incentive and equity compensation.

Home office depreciation and amortization. Home office depreciation and amortization expense totaled \$1.6 million for the year ended December 31, 2017, an increase of \$0.1 million compared to the year ended December 31, 2016. The increase was primarily attributable to additional depreciation expense from assets related to our IT infrastructure.

Interest expense. Interest expense was \$12.9 million for the year ended December 31, 2017 compared to \$11.7 million for the year ended December 31, 2016, an increase of \$1.2 million. During the year ended December 31, 2017, interest expense increased by approximately \$0.8 million related to our term note and revolving credit facility and by \$0.4 million related to our deferred purchase obligations for our 2016 acquisitions. During the year ended December 31, 2017, the weighted average interest rate increased 0.4% compared to the same period in 2016.

Accretion of discount on convertible notes. For the year ended December 31, 2017, we recognized accretion of the discount on our convertible subordinated notes of \$4.3 million compared to \$3.9 million for the same period in 2016. Accretion is calculated using the effective interest method based on a stated interest rate of 6.75% and will increase each year through to maturity.

Other, net. For the year ended December 31, 2017, we recognized a net gain of \$1.1 million on the following transactions: (i) \$0.9 million gain on the sale of land and (ii) \$0.2 million gain on the sale of a funeral home business and other assets.

Income taxes. Our income tax benefit was \$4.4 million for the year ended December 31, 2017 compared to our income tax provision of \$12.7 million for the year ended December 31, 2016. Our tax rate, before discrete items was 40.0% and 39.7% for the years ended December 31, 2017 and 2016, respectively. We recorded a \$17.2 million discrete tax benefit due to the re-measurement of our deferred tax assets and liabilities to reflect the impact of the recent tax law change that was enacted on December 22, 2017. At December 31, 2017, no uncertain tax positions were identified.

OVERVIEW OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of the Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. On an on-going basis, we evaluate estimates and judgments, including those related to revenue recognition, realization of accounts receivable, inventories, goodwill, other intangible assets, property and equipment and deferred tax assets and liabilities. We base our estimates on historical experience, third party data and assumptions that we believe to be reasonable under the circumstances. The results of these considerations form the basis for making judgments about the amount and timing of revenue and expenses, the carrying value of assets and the recorded amounts of liabilities. Actual results may differ from these estimates and such estimates may change if the underlying conditions or assumptions change. Historical performance should not be viewed as indicative of future performance because there can be no assurance the margins, operating income and net earnings, as a percentage of revenue, will be consistent from year to year.

“Management’s Discussion and Analysis of Financial Condition and Results of Operations” (“MD&A”) is based upon our Consolidated Financial Statements presented herewith, which have been prepared in accordance with United States GAAP. Our critical accounting policies are more fully described in Part II, Item 8, Financial Statements and Supplementary Data, Note 1. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our Consolidated Financial Statements.

Revenue Recognition - Funeral Home Operations

Our funeral home operations are principally service businesses that generate revenue from sales of burial and cremation services and related merchandise, such as caskets and urns. Funeral services include consultation, the removal and preparation of remains, the use of funeral home facilities for visitation and remembrance services and transportation services. We provide funeral services and products on both an atneed and preneed basis.

Funeral arrangements sold at the time of death are referred to as atneed funeral contracts. The performance obligation on these atneed contracts for both merchandise and services are bundled as a single performance obligation, as the performance of these obligations occur within a short time frame (usually within a few days) from the time of death to the funeral service. Although our performance activities are transferred in sequence such as, embalming the body, delivering the casket, obtaining service related items like flowers and performing the service, these are all essential to satisfy our contractual obligation to the customer, thus, bundled into a single performance obligation. Revenue is recognized on the date of funeral service, as all performance obligations have been satisfied. Payment is due at or before time of transfer. Outstanding balances due from customers, if any, on atneed funeral contracts are included in *Accounts receivable* on our Consolidated Balance Sheet.

Funeral arrangements sold prior to death occurring are referred to as preneed funeral contracts. In many instances, the customer pays for the preneed contract over a period of time. For preneed funeral merchandise and service contracts, the performance obligation occurs at the time of need (when death occurs) and revenue is recognized on the date of delivery of merchandise or performance of service. We do not deliver merchandise on preneed contracts or provide service prior to the time of death. The performance obligation for preneed funeral contracts is similar to the elements of the performance obligation of atneed funeral contracts. For preneed funeral services, all preneed funeral contracts are re-written upon the date of death as an atneed contract. The performance obligation is satisfied at the date of the service.

Revenue from preneed funeral contracts, along with accumulated earnings, is deferred until the time the merchandise is delivered or the service is performed. The principal and accumulated earnings of the trusts are withdrawn at maturity (death) or cancellation. The cumulative trust income earned and the increases in insurance benefits on the insurance products are recognized when the service is performed. The amounts deposited in trusts that we control are included in the non-current asset section of our Consolidated Balance Sheet. Beginning January 1, 2018, balances due on undelivered preneed funeral trust contracts have been reclassified to reduce *Deferred preneed funeral revenue* on our Consolidated Balance Sheet.

Our funeral receivables recorded in *Accounts Receivable, net* primarily consist of amounts due for funeral services already performed. We estimate an allowance for doubtful accounts on these receivables based on our historical experience and we monitor changes in delinquency rates and provide additional bad debt and cancellation reserves when warranted.

When preneed funeral contracts are funded through third-party insurance policies, we earn a commission on the sale of the policies. Insurance commissions are subject to refund (charge-back) if the preneed policy is cancelled within a year or if there is an imminent death of beneficiary before the first year anniversary of the policy. We record these insurance commissions as *Other revenue* when the commission is no longer subject to refund, which is typically one year after the policy is issued. All selling costs incurred pursuant to the sale of the insurance funded preneed contracts are expensed as incurred. Preneed funeral contracts to be funded at maturity by third-party insurance policies are not recorded as assets or liabilities on our Consolidated Balance Sheet.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 6 for additional information.

Revenue Recognition - Cemetery Operations

Our cemetery operations generate revenue primarily through sales of cemetery interment rights (primarily grave sites, lawn crypts, mausoleum spaces and niches), related cemetery merchandise (such as outer burial containers, memorial markers and floral placements) and services (interments, inurnments and installation of cemetery merchandise). We provide cemetery services and products on both an atneed and preneed basis.

Cemetery arrangements sold at the time of death are referred to as atneed cemetery contracts. The performance obligation on these atneed contracts for cemetery property, merchandise and services are distinct. The performance obligations from the time of death to the disposition of the remains, include delivering cemetery property, unearthing the ground, interring remains and installing merchandise on the cemetery grounds. Each item on the contract is recognized as a distinct good or service. The performance obligation is satisfied and revenue is recognized on the purchase date of the interment right, on the date of the cemetery service, and on the date of delivery of the merchandise (set on cemetery grounds). Payment is due at or before time of transfer. Outstanding balances due from customers, if any, on completed atneed contracts are included in *Accounts receivable* on our Consolidated Balance Sheet.

Cemetery arrangements sold prior to death occurring are referred to as preneed cemetery contracts. For preneed cemetery interment rights, the performance obligation is the sale of the interment right and revenue is recognized at the time the contract is signed. Control of cemetery interment rights is transferred to the customer upon execution of the contract as customers select a specific location and space for their interment right, thus, restricting us from other use or transfer of the contracted cemetery property. The interment right is deeded to the customer when the contract is paid in full.

For preneed cemetery merchandise and service, the performance obligation occurs at the time of need (when death occurs) and revenue is recognized on the date of delivery of merchandise or performance of service. We do not deliver merchandise on preneed contracts or provide service prior to the time of death. The performance obligation for preneed cemetery merchandise and service is similar to the elements of the performance obligation of atneed cemetery merchandise and service.

Preneed cemetery contracts are usually financed through interest-bearing installment sales contracts, generally with terms of up to five years. In substantially all cases, we receive an initial down payment at the time the contract is signed. Earnings on these installment contracts are not recognized until the time the merchandise is transferred or the service is performed and are recorded as *Other revenue*.

The performance of the preneed cemetery contracts is secured by placing the funds collected, less amounts that we may retain under state regulations, in trust for the benefit of the customer, the proceeds of which will pay for such services at the time of need. This method is intended to fund preneed contracts, cover the original contract price and generally include an element of growth (earnings) designed to offset future inflationary cost increases. The amounts deposited in trusts that we control are included in the non-current asset section of our Consolidated Balance Sheet. Balances due from customers on delivered preneed cemetery contracts are included in *Accounts receivable* and *Preneed receivables* on our Consolidated Balance Sheet. Beginning January 1, 2018, balances due on undelivered preneed cemetery contracts have been reclassified to reduce *Deferred preneed cemetery revenue* on our Consolidated Balance Sheet.

Allowances for bad debts and customer cancellations on cemetery financed receivables are provided at the date that the sale is recognized as revenue and are based on our historical experience. We also monitor changes in delinquency rates and provide additional bad debt and cancellation reserves when warranted. We have a collections policy where past due notifications are sent to the customer beginning at 15 days past due and periodically thereafter until the contract is cancelled or payment is received. We reserve 100% of the receivables on contracts in which the revenue has been recognized and payments are 90 days past due or more.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 6 for additional information.

Arrangements with Multiple Performance Obligations

Some of our contracts with customers include multiple performance obligations. For these contracts, we allocate transaction price to each performance obligation based on its relative standalone selling price, which is based on prices charged to customers per our general price list. Packages for service and ancillary items are offered to help the customer make decisions during emotional/stressful times. Package discounts are reflected net in *Revenue*. We recognize revenue when the merchandise is transferred or the service is performed, in satisfaction of the corresponding performance obligation. Sales taxes collected are recognized on a net basis in our Consolidated Financial Statements.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 6 for additional information.

Preneed Funeral and Cemetery Trust Funds

Our preneed and perpetual care trust funds are reported in accordance with the principles of consolidating Variable Interest Entities (“VIE’s”). In the case of preneed trusts, the customers are the legal beneficiaries. In the case of perpetual care trusts, we do not have a right to access the corpus in the perpetual care trusts. We have recognized financial interests of third parties in the trust funds in our financial statements as *Deferred preneed funeral and cemetery receipts held in trust* and *Care trusts’ corpus*. The investments of such trust funds are classified as available-for-sale and are reported at fair market value; therefore, the unrealized gains and losses, as well as accumulated and undistributed income and realized gains and losses are recorded to *Deferred preneed funeral and cemetery receipts held in trust* and *Care trusts’ corpus* on our Consolidated Balance Sheet. Our future obligations to deliver merchandise and services are reported at estimated settlement amounts. Preneed funeral and cemetery trust investments are reduced by the trust investment earnings that we have been allowed to withdraw in certain states prior to maturity. These earnings, along with preneed contract collections not required to be placed in trust, are recorded in *Deferred preneed funeral revenue* and *Deferred preneed cemetery revenue* until the service is performed or the merchandise is delivered.

In accordance with respective state laws, we are required to deposit a specified amount into perpetual and memorial care trust funds for each interment right and certain memorials sold. Income from the trust funds is distributed to us and used to provide for the care and maintenance of the cemeteries and mausoleums. Such trust fund income is recognized as revenue when realized by the trust and distributable to us. We are restricted from withdrawing any of the principal balances of these funds.

An enterprise is required to perform an analysis to determine whether the enterprise’s variable interest(s) give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has both the power to direct the activities of the VIE that most significantly impact the entity’s economic performance and the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. Our analysis continues to support our position as the primary beneficiary in the majority of our funeral and cemetery trust funds.

Trust management fees are earned by us for investment management and advisory services that are provided by our wholly-owned registered investment advisor (“CSV RIA”) and are recorded as *Other revenue*. As of December 31, 2018, CSV RIA provided these services to one institution, which has custody of approximately 75% of our trust assets, for a fee based on the market value of trust assets. Under state trust laws, we are allowed to charge the trust a fee for advising on the investment of the trust assets and these fees are recognized as income in the period in which services are provided.

We determine whether or not the assets in the preneed trusts have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis of the investment due to an other-than-temporary impairment is likewise recorded as a reduction to *Deferred preneed funeral and cemetery receipts held in trust* and *Care trusts’ corpus* on our Consolidated Balance Sheet. There will be no impact on earnings unless and until such time that the investment is withdrawn from the trust in accordance with state regulations at an amount that is less than its original basis.

See Part II, Item 8, Financial Statements and Supplementary Data, Notes 7, 9 and 11 for additional related disclosures.

Capitalized Commissions on Preneed Contracts

Effective January 1, 2018, we adopted the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Update (“ASU”), *Revenue from Contracts with Customers (Topic 606)*, which impacted our accounting for incremental selling costs, primarily commission costs, related to preneed cemetery merchandise and services and preneed funeral trust contracts.

Upon adoption of Topic 606, we capitalize sales commissions and other direct selling costs related to preneed cemetery merchandise and services and preneed funeral trust contracts as these costs are incremental and recoverable costs of obtaining a contract with a customer. Our capitalized commissions on preneed contracts are amortized on a straight-line basis over the average maturity period for our preneed cemetery merchandise and services contracts and preneed funeral trust contracts, of eight and ten years, respectively.

The selling costs related to the sales of cemetery interment rights, which include real property and other costs related to cemetery development activities, continue to be expensed using the specific identification method in the period in which the sale of the cemetery interment right is recognized as revenue. The selling costs related to preneed funeral insurance contracts continue to be expensed in the period incurred as these contracts are not included on our Consolidated Balance Sheet.

On September 30, 2018, our management agreement with a Florida municipality expired and as a result, we ceased to operate three of our cemetery businesses. We recorded a loss of approximately \$125,000 in *Other, net*, for the write-off of capitalized commissions related to these three cemetery businesses.

See Part II, Item 8, Financial Statements and Supplementary Data, Notes 5 and 13 for additional information.

Long-Lived Assets

Long-lived assets, such as property, plant and equipment subject to depreciation and amortization, are reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with the Property, Plant and Equipment topic of the Accounting Standards Codification (“ASC”) 360. This guidance requires that long-lived assets to be held and used are reported at the lower of their carrying amount or fair value. We assess long-lived assets for impairment whenever events or circumstances indicate that the carrying value may be greater than the fair value. We evaluate our long-lived assets for impairment when a funeral home or cemetery business has negative earnings before interest, taxes, depreciation and amortization (“EBITDA”) for four consecutive years and if there has been a decline in EBITDA in that same period. We review our long-lived assets deemed held-for-sale to the point of recoverability. Assets to be disposed of and assets not expected to provide any future service potential are recorded at the lower of their carrying amount or fair value less estimated cost to sell. If we determine that the carrying value is not recoverable from the proceeds of the sale, we record an impairment at that time.

During 2018, we recorded an impairment of \$0.2 million related to the real property of a funeral home business held for sale, as the carrying value exceeded fair value. For the years ended December 31, 2016 and 2017, no impairments were identified on our long-lived assets.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 1 for additional information.

Business Combinations

Tangible and intangible assets acquired and liabilities assumed are recorded at fair value and goodwill is recognized for any difference between the price of the acquisition and fair value. We recognize the assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at the acquisition date, measured at the fair value as of that date. Acquisition related costs are recognized separately from the acquisition and are expensed as incurred. We customarily estimate related transaction costs known at closing. To the extent that information not available to us at the closing date subsequently becomes available during the allocation period, we may adjust goodwill, intangible assets, assets or liabilities associated with the acquisition.

During 2018, we acquired four funeral home businesses. In July 2018, we acquired one funeral home business in Fredericksburg, Virginia and one funeral home business in Stafford, Virginia. In August 2018, we acquired one funeral home business in Cookeville, Tennessee and one funeral home business in Knightdale, North Carolina.

During 2017, we acquired seven funeral home businesses. We acquired one funeral home business in Longmont, Colorado and one funeral home business in Loveland, Colorado in November 2017 and five funeral home businesses on Long Island, New York in December 2017.

The pro forma impact of the acquisitions on prior periods is not presented as the impact is not material to our reported results. The results of the acquired businesses are included in our results of operations from the date of acquisition.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 3 for additional information.

Goodwill

The excess of the purchase price over the fair value of identifiable net assets of funeral home businesses acquired is recorded as goodwill. Goodwill has primarily been recorded in connection with the acquisition of funeral home businesses. Goodwill has an indefinite life and is not subject to amortization. As such, we test goodwill for impairment on an annual basis. Our intent is to perform a quantitative impairment test at least once every three years unless certain indicators or events suggest otherwise and perform a qualitative assessment during the remaining two years.

Our quantitative goodwill impairment test involves estimates and management judgment. In the quantitative analysis, we compare the fair value of each reporting unit to its carrying value, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, the goodwill of that reporting unit is not considered impaired. We determine fair value for each reporting unit using both an income approach, weighted 90%, and a market approach, weighted 10%. Our methodology for determining an income-based fair value is based on discounting projected future cash flows. The projected future cash flows include assumptions concerning future operating performance and economic conditions that may differ from actual future cash flows discounted at our weighted average cost of capital based on market participant assumptions. Our methodology for determining a market approach fair value utilizes the guideline public company method, in which we rely on market multiples of comparable companies operating

in the same industry as the individual reporting units. In accordance with the guidance, if the fair value of the reporting unit is less than its carrying amount an impairment charge is recorded in an amount equal to the difference.

For our 2018 annual impairment test, we performed a qualitative assessment, using information as of August 31, 2018. Under current guidance, we are permitted to first assess qualitative factors to determine whether it is more-likely-than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a quantitative goodwill impairment test. We determined that there were no factors that would indicate the need to perform a quantitative goodwill impairment test and concluded that it is more-likely-than not that the fair value of our reporting units is greater than their carrying value and thus there was no impairment to goodwill.

For our 2017 annual impairment test, we performed a qualitative assessment and concluded that the fair value of our reporting units was greater than their carrying value and thus there was no impairment to goodwill.

In addition to our annual review, we assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value of a reporting unit may be greater than fair value. Factors that could trigger an interim impairment review include, but are not limited to, significant adverse changes in the business climate which may be indicated by a decline in our market capitalization or decline in operating results.

During 2018, we recorded an impairment of \$0.8 million related to a funeral home business that we intend to cease operating in 2019, as the carrying value exceeded fair value. No impairments were recorded to our goodwill during the years ended December 31, 2016 and 2017. No such events or changes occurred between the testing date and year end to trigger a subsequent impairment review.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 4 for additional information.

Intangible Assets

Our intangible assets include tradenames resulting from acquisitions and are included in *Intangible and other non-current assets* on our Consolidated Balance Sheet. Our tradenames are considered to have an indefinite life and are not subject to amortization. As such, we test our intangible assets for impairment on an annual basis. Our intent is to perform a quantitative impairment test at least once every three years unless certain indicators or events suggest otherwise and perform a qualitative assessment during the remaining two years.

Our quantitative intangible asset impairment test involves estimates and management judgment. Our quantitative analysis is performed using the relief from royalty method, which measures the tradenames by determining the value of the royalties that we are relieved from paying due to our ownership of the asset. We determine the fair value of the asset by discounting the cash flows that represent a savings in lieu of paying a royalty fee for use of the tradename. The discounted cash flow valuation uses projections of future cash flows and includes assumptions concerning future operating performance and economic conditions that may differ from actual future cash flows and the determination and application of an appropriate royalty rate and discount rate. To estimate the royalty rates for the individual tradename, we mainly rely on the profit split method, but also consider the comparable third-party license agreements and the return on asset method. A scorecard is used to assess the relative strength of the individual tradename to further adjust the royalty rates selected under the profit-split method for qualitative factors. In accordance with the guidance, if the fair value of the tradename is less than its carrying amount an impairment charge is recorded in an amount equal to the difference.

For our 2018 annual impairment test, we performed a qualitative assessment, using information as of August 31, 2018. Under current guidance, we are permitted to first assess qualitative factors to determine whether it is more-likely-than not that the fair value of the tradename is less than its carrying amount as a basis for determining whether it is necessary to perform a quantitative impairment test. We determined that there were no factors that would indicate the need to perform a quantitative impairment test and concluded that it is more likely than not that the fair value of our intangible assets is greater than its carrying value and thus there was no impairment to our intangible assets.

For our 2017 annual impairment test, we performed a qualitative assessment and concluded that the fair value of our intangible assets was greater than its carrying value and thus there was no impairment to our intangible assets.

In addition to our annual review, we assess the impairment of intangible assets whenever certain events or changes in circumstances indicate that the carrying value of the intangible asset may be greater than the fair value. Factors that could trigger an interim impairment review include, but are not limited to, significant under-performance relative to historical or projected future operating results and significant negative industry or economic trends. During 2016, we recorded an impairment to tradenames of \$145,000 related to a funeral home business held for sale as the carrying value exceeded fair value. No other impairments were recorded to our intangible assets during the years ended December 31, 2016, 2017 and 2018.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 13 for additional information.

Divested Operations

During 2018, our management agreement with a Florida municipality expired and as a result, we ceased to operate three of our cemetery businesses. During 2017, we sold a funeral home business in Kentucky for \$0.6 million and during 2016, we sold a funeral home business in Tennessee for \$1.35 million. The operating results of these divested businesses are reflected in our Consolidated Statements of Operations.

We continually review locations to optimize the sustainable earning power and return on our invested capital. These reviews could entail selling certain non-strategic businesses.

See Part II, Item 8, Financial Statements and Supplementary Data, Notes 5 for additional information.

Fair Value Measurements

We measure the available-for-sale securities held by our funeral merchandise and service, cemetery merchandise and service, and cemetery perpetual care trusts at fair value on a recurring basis in accordance with the Fair Value Measurements Topic of the ASC. This guidance defines fair value as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The guidance establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets;
- Level 2 — inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and
- Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

We disclose the extent to which fair value is used to measure financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date. The fair value disclosures of transfers in and out of Levels 1 and 2 and the gross presentation of purchases, sales, issuances and settlements in the Level 3 reconciliation of the three-tier fair value hierarchy are also presented in Notes 7 and 11 to the Consolidated Financial Statements included herein. We currently do not have any assets that have fair values determined by Level 3 inputs and no liabilities measured at fair value. We have not elected to measure any additional financial instruments and certain other items at fair value that are not currently required to be measured at fair value.

To determine the fair value of assets and liabilities in an environment where the volume and level of activity for the asset or liability have significantly decreased, the exit price is used as the fair value measurement. For the year ended December 31, 2018, we did not incur significant decreases in the volume or level of activity of any asset or liability. We consider an impairment of debt and equity securities other-than-temporary unless (a) we have the ability and intent to hold an investment and (b) evidence indicating the cost of the investment is recoverable before we are more likely than not required to sell the investment. If an impairment is indicated, then an adjustment is made to reduce the carrying amount to fair value which is recorded as a reduction to either *Deferred preneed cemetery receipts held in trust*, *Deferred preneed funeral receipts held in trust* or *Care trusts' corpus* on our Consolidated Balance Sheet. We did not record any impairments during the year ended December 31, 2017 and 2018.

In the ordinary course of business, we are typically exposed to a variety of market risks. Currently, these are primarily related to changes in fair market values related to outstanding debts and changes in the values of securities associated with the preneed and perpetual care trusts. Management is actively involved in monitoring exposure to market risk and developing and utilizing risk management techniques when appropriate and when available for a reasonable price.

See Part II, Item 8, Financial Statements and Supplementary Data, Notes 7, 11 and 12 for additional information.

Income Taxes

We and our subsidiaries file a consolidated U. S. federal income tax return, separate income tax returns in 16 states in which we operate and combined or unitary income tax returns in 13 states in which we operate. We record deferred taxes for temporary differences between the tax basis and financial reporting basis of assets and liabilities. We classify our deferred tax liabilities and assets as non-current on our Consolidated Balance Sheet.

We record a valuation allowance to reflect the estimated amount of deferred tax assets for which realization is uncertain. Management reviews the valuation allowance at the end of each quarter and makes adjustments if it is determined that it is more likely than not that the tax benefits will be realized.

We analyze tax benefits for uncertain tax positions and how they are to be recognized, measured, and derecognized in the financial statements; provide certain disclosures of uncertain tax matters; and specify how reserves for uncertain tax positions should be classified on our Consolidated Balance Sheet.

On May 10, 2017, we filed amended federal returns for the tax years ending December 31, 2013, 2014 and 2015, which generated significant refunds. As a result, on July 18, 2017, we received notification that the Internal Revenue Service (“IRS”) selected our tax years ended December 31, 2013, 2014 and 2015 for a limited scope examination to verify the refunds due. The examinations are in progress, however, the timing of the conclusion of the audit is uncertain.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (“the Tax Act”). The Tax Act makes broad and complex changes to the U.S. tax code. Effective as of January 1, 2018, the Tax Act established new tax laws, including but not limited to (1) a reduction of the corporate tax rate from a top marginal rate of 35% to a flat rate of 21%; (2) a limitation of the tax deduction for interest expense to 30% of adjusted earnings; (3) a limitation of the deduction for net operating losses to 80% of current year taxable income and elimination of net operating loss carrybacks; (4) limitations of certain executive compensation deductions; and (5) limitations or repeals of many business deductions and credits.

The analysis required by Staff Accounting Bulletin (“SAB”) 118 to determine the impact of the Tax Act was complete as of December 31, 2017. Return to provision adjustments recorded in the fourth quarter of 2018 resulted in additional favorable impact from the rate reduction as there were changes to the deferred balances recorded.

On December 21, 2018, we filed 3 Form 3115s, Application for Change in Accounting Method, and associated statements with the requesting consent to change the method of accounting for deferred revenue for our cemetery property and cemetery merchandise and service operations for the taxable year beginning January 1, 2018 and ending December 31, 2018. The application requesting a change in the method of accounting for recognizing advance payments received under preneed contracts for cemetery services and merchandise is to comply with Internal Revenue Code (I.R.C.) Sections 61, 451, and 471. The change in method of accounting for constructed and unconstructed cemetery property is to comply with I.R.C Sections 61, 451, 1001, 1012 and 460. The method changes filed are non-automatic and require IRS approval. The impact of the change in the method of accounting for deferred revenue will be recorded in the interim period in which the method changes are approved. The method changes are expected to be approved, but the timing of the approval is uncertain. Additionally, once approved the method changes will result in significant favorable deductions and will have a favorable impact on cash taxes paid during 2019.

We do not have any unrecognized tax benefits recorded as of December 31, 2018 and we do not anticipate a material change in our unrecognized tax benefits during the next twelve months.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 18 for additional information.

Stock Plans and Stock-Based Compensation

We have stock-based employee and director compensation plans under which we grant stock, restricted stock, stock options and performance awards. We also have an employee stock purchase plan (“ESPP”). We recognize compensation expense in an amount equal to the fair value of the stock-based awards expected to vest or to be purchased over the requisite service period.

Fair value is determined on the date of the grant. The fair value of restricted stock is determined using the stock price on the grant date. The fair value of options or awards containing options is determined using the Black-Scholes valuation model. The fair value of the performance awards related to market performance is determined using a Monte-Carlo simulation pricing model. The fair value of the performance awards related to internal performance metrics is determined using the stock price on the grant date. The fair value of the ESPP is determined based on the discount element offered to employees and the embedded option element, which is determined using an option calculation model.

We recognize all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) as income tax expense or benefit in the income statement. We treat the tax effects of exercised or vested awards as discrete items in the reporting period in which they occur. For the years ended December 31, 2017 and 2018, the excess tax deficiency related to share-based payments was approximately \$0.1 million and \$0.8 million, respectively, recorded within *Tax adjustment related to certain discrete items* on our Consolidated Statements of Operations. Excess tax benefits or deficiencies related to share-based payments are included in operating cash flows.

Amounts withheld from restricted stock vestings and stock option exercises for the purpose of paying employee related taxes are presented as financing activities on our Consolidated Statement of Cash Flows. For the years ended December 31, 2016, 2017 and 2018, we withheld shares to pay employee taxes in the amount of \$0.6 million, \$0.5 million and \$0.7 million. Prior to January 1, 2017, these amounts were presented as operating activities on our Consolidated Statement of Cash Flows.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 19 for additional information.

Computation of Earnings per Common Share

Basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period. Dilutive common equivalent shares consist of stock options and our Convertible Notes.

Share-based awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are recognized as participating securities and included in the computation of both basic and diluted earnings per share. Our grants of restricted stock awards to our employees and directors are considered participating securities, and we have prepared our earnings per share calculations attributable to common stockholders to exclude outstanding unvested restricted stock awards, using the two-class method, in both the basic and diluted weighted average shares outstanding calculation.

The fully diluted weighted average shares outstanding for the years ended December 31, 2016, 2017 and 2018, and the corresponding calculation of fully diluted earnings per share, included 0.5 million, 0.9 million and 0.3 million shares that would have been issued upon the conversion of our Convertible Notes as a result of the application of the if-converted method prescribed by the FASB ASC 260.

The calculations for basic and diluted earnings per share for the three years ended December 31, 2016, 2017 and 2018 are presented in Part II, Item 8, Financial Statements and Supplementary Data, Note 21.

Correction of Immaterial Error

During the year ended December 31, 2017, we corrected an immaterial error related to 2013. The adjustment related to the correction of the deferred tax liability for the difference in book and tax basis of certain assets. The error had the impact of understating the deferred tax liability and overstating net income in 2013. Management evaluated the effect of the adjustment on previously issued interim and annual consolidated financial statements in accordance with the SEC's SAB No. 99 and SAB 108 and concluded that it was immaterial to the interim and annual periods. As a result, in accordance with SAB No. 108, we corrected our Consolidated Balance Sheet as of January 1, 2015.

The effect of this adjustment on our Consolidated Balance Sheet as of December 31, 2017 was as follows (dollars in thousands):

		December 31, 2017
		% Change
Increase in Deferred tax liability	\$ 2,255	7.8%
Increase in Total liabilities	\$ 2,255	0.3%
Decrease in Retained earnings	\$ 2,255	3.7%
Decrease in Total stockholders' equity	\$ 2,255	1.1%

This adjustment had no impact on our Consolidated Statements of Operations or Consolidated Statement of Cash Flows for the year ended December 31, 2017.

Related Party Transactions

Management evaluated reportable events and transactions that occurred between us and related persons during the year ended December 31, 2018.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 26 for additional information.

Subsequent Events

We have evaluated events and transactions during the period subsequent to December 31, 2018 through the date the financial statements were issued for potential recognition or disclosure in the accompanying financial statements covered by this report.

RECENT ACCOUNTING PRONOUNCEMENTS, ACCOUNTING CHANGES AND OTHER REGULATIONS

For discussion of recent accounting pronouncements and accounting changes, see Note 2 in Part II, Item 8. Financial Statements and Supplementary Data.

SEASONALITY

Our business can be affected by seasonal fluctuations in the death rate. Generally, the number of deaths is higher during the winter months because the incidences of death from influenza and pneumonia are higher during this period than other periods of the year.

INFLATION

Inflation has not had a material impact on our results of operations over the last three fiscal years.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

In the ordinary course of business, we are typically exposed to a variety of market risks. Currently, these are primarily related to interest rate risk and changes in the values of securities associated with the preneed and perpetual care trusts. Management is actively involved in monitoring exposure to market risk and developing and utilizing appropriate risk management techniques when appropriate and when available for a reasonable price. We are not exposed to any other significant market risks.

The following quantitative and qualitative information is provided about financial instruments to which we are a party at December 31, 2018 and from which we may incur future gains or losses from changes in market conditions. We do not enter into derivative or other financial instruments for speculative or trading purposes.

Hypothetical changes in interest rates and the values of securities associated with the preneed and perpetual care trusts chosen for the following estimated sensitivity analysis are considered to be reasonable near-term changes generally based on consideration of past fluctuations for each risk category. However, since it is not possible to accurately predict future changes in interest rates, these hypothetical changes may not necessarily be an indicator of probable future fluctuations.

The following information about our market-sensitive financial instruments constitutes a “forward-looking statement.”

In connection with our preneed funeral operations and preneed cemetery merchandise and service sales, the related funeral and cemetery trust funds own investments in equity and debt securities and mutual funds, which are sensitive to current market prices. Cost and market values of such investments as of December 31, 2018 are presented in Part II, Item 8, Financial Statements and Supplementary Data, Notes 7, 9 and 11. The sensitivity of the fixed income securities is such that a 0.25% change in interest rates causes an approximate 1.88% change in the value of the fixed income securities.

We monitor current and forecasted interest rate risk in the ordinary course of business and seek to maintain optimal financial flexibility, quality and solvency. As of December 31, 2018, we had outstanding borrowings under the New Credit Facility of \$27 million. Any further borrowings or voluntary prepayments against the New Credit Facility or any change in the floating rate would cause a change in interest expense. We have the option to pay interest under our New Credit Facility at either the prime rate or the LIBOR rate plus a margin. At December 31, 2018, the prime rate margin was equivalent to 0.875% and the LIBOR margin was 1.875%. Assuming the outstanding balance remains unchanged, a change of 100 basis points in our borrowing rate would result in a change in income before taxes of \$0.3 million. We have not entered into interest rate hedging arrangements in the past. Management continually evaluates the cost and potential benefits of interest rate hedging arrangements.

Our Convertible Notes bear interest at the fixed annual rate of 2.75%. The Convertible Notes do not contain a call feature. At December 31, 2018, the cost of the Convertible Notes on our Consolidated Balance Sheet was \$5.8 million and the fair value of the Convertible Notes was \$6.2 million based on the last traded or broker quoted price, as reported by the Financial Industry Regulatory Authority, Inc. (“FINRA”). Increases in market interest rates may cause the value of the Convertible Notes to decrease, but such changes will not affect our interest costs.

Our Senior Notes bear interest at the fixed annual rate of 6.625%. We may redeem all or part of the Senior Notes at any time prior to June 1, 2021 at a redemption price equal to 100% of the principal amount of Senior Notes redeemed, plus a “make whole” premium, and accrued and unpaid interest, if any, to the date of redemption. We have the right to redeem the Senior Notes at any time on or after June 1, 2021 at the redemption prices described in the Indenture, plus accrued and unpaid interest, if any, to the date of redemption. At December 31, 2018, the cost of the Senior Notes on our Consolidated Balance Sheet was \$320.4 million and the fair value of the Senior Notes notes was \$324.6 million based on the last traded or broker quoted price as reported by FINRA. Increases in market interest rates may cause the value of the Senior Notes to decrease, but such changes will not affect our interest costs.

The remainder of our long-term debt and leases consist of non-interest bearing notes and fixed rate instruments that do not trade in a market and do not have a quoted market value. Any increase in market interest rates causes the fair value of those liabilities to decrease, but such changes will not affect our interest costs.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

**CARRIAGE SERVICES, INC.
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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Carriage Services, Inc.:

Opinion on the financial statements

We have audited the accompanying consolidated balance Sheet of Carriage Services, Inc. (a Delaware corporation) and subsidiaries (the “Company”) as of December 31, 2017 and 2018, the related consolidated statements of operations, changes in stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes and schedule (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in the 2013 Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), and our report dated February 28, 2019 expressed an unqualified opinion.

Change in accounting principle

As discussed in Note 1 to the consolidated financial statements, the Company has changed its method of accounting for preneed property sales and selling costs in 2018 due to the adoption of ASC 606, Revenue From Contracts with Customers.

Basis for opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ GRANT THORNTON LLP

We have served as the Company's auditor since 2014.

Houston, Texas
February 28, 2019

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Carriage Services, Inc.:

Opinion on internal control over financial reporting

We have audited the internal control over financial reporting of Carriage Services, Inc. (a Delaware corporation) and subsidiaries (the “Company”) as of December 31, 2018, based on criteria established in the 2013 *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in the 2013 *Internal Control-Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the consolidated financial statements of the Company as of and for the year ended December 31, 2018, and our report dated February 28, 2019 expressed an unqualified opinion on those financial statements.

Basis for opinion

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and limitations of internal control over financial reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ GRANT THORNTON LLP

Houston, Texas
February 28, 2019

CARRIAGE SERVICES, INC.
CONSOLIDATED BALANCE SHEET
(in thousands, except share data)

	December 31,	
	2017	2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 952	\$ 644
Accounts receivable, net of allowance for bad debts of \$835 in 2017 and \$769 in 2018	19,655	18,897
Inventories	6,519	6,751
Prepaid expenses	2,028	1,456
Other current assets	986	1,555
Total current assets	30,140	29,303
Preneed cemetery trust investments	73,853	62,432
Preneed funeral trust investments	90,682	82,074
Preneed receivables, net of allowance for bad debts of \$2,278 in 2017 and \$2,151 in 2018	31,644	18,441
Receivables from preneed trusts	15,287	17,073
Property, plant and equipment, net of accumulated depreciation of \$115,776 in 2017 and \$124,945 in 2018	247,294	260,838
Cemetery property, net of accumulated amortization of \$37,543 in 2017 and \$37,668 in 2018	76,331	74,958
Goodwill	287,956	303,887
Intangible and other non-current assets	18,117	24,425
Cemetery perpetual care trust investments	50,229	44,071
Total assets	\$ 921,533	\$ 917,502
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	\$ 17,251	\$ 2,327
Accounts payable	6,547	9,987
Other liabilities	1,361	1,236
Accrued liabilities	17,559	21,408
Total current liabilities	42,718	34,958
Long-term debt, net of current portion	121,034	6,925
Credit facility	91,120	26,145
Convertible subordinated notes due 2021	124,441	5,732
Senior notes due 2026	—	319,108
Obligations under capital leases, net of current portion	6,361	6,143
Deferred preneed cemetery revenue	54,690	45,997
Deferred preneed funeral revenue	34,585	28,606
Deferred tax liability	31,159	31,263
Other long-term liabilities	3,378	3,133
Deferred preneed cemetery receipts held in trust	73,853	62,432
Deferred preneed funeral receipts held in trust	90,682	82,074
Care trusts' corpus	49,856	43,494
Total liabilities	723,877	696,010
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$.01 par value; 80,000,000 shares authorized; 22,622,242 and 25,703,490 issued as of December 31, 2017 and 2018, respectively	226	257
Additional paid-in capital	216,158	243,849
Retained earnings	57,904	71,680
Treasury stock, at cost; 6,523,370 and 7,625,339 shares at December 31, 2017 and 2018, respectively	(76,632)	(94,294)
Total stockholders' equity	197,656	221,492
Total liabilities and stockholders' equity	\$ 921,533	\$ 917,502

The accompanying notes are an integral part of these Consolidated Financial Statements.

CARRIAGE SERVICES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Year Ended December 31,		
	2016	2017	2018
Revenue:			
Service revenue	\$ 124,361	\$ 132,592	\$ 138,604
Property and merchandise revenue	105,210	108,046	112,253
Other revenue	18,629	17,501	17,135
	<u>248,200</u>	<u>258,139</u>	<u>267,992</u>
Field costs and expenses:			
Cost of service	61,586	66,884	72,123
Cost of merchandise	81,079	85,422	90,008
Cemetery property amortization	3,905	3,350	3,602
Field depreciation expense	10,014	11,024	12,015
Regional and unallocated funeral and cemetery costs	10,844	13,339	12,749
Other expenses	1,122	1,321	1,548
	<u>168,550</u>	<u>181,340</u>	<u>192,045</u>
Gross profit	79,650	76,799	75,947
Corporate costs and expenses:			
General, administrative and other	27,944	26,253	30,827
Home office depreciation and amortization	1,502	1,605	1,813
	<u>29,446</u>	<u>27,858</u>	<u>32,640</u>
Operating income	50,204	48,941	43,307
Interest expense	(11,738)	(12,948)	(21,109)
Accretion of discount on 2.75% convertible subordinated notes	(3,870)	(4,329)	(2,192)
Loss on early extinguishment of debt	(567)	—	(502)
Other, net	(1,788)	1,118	(1,238)
Income before income taxes	32,241	32,782	18,266
Provision for income taxes	(12,682)	(13,100)	(5,754)
Tax adjustment related to certain discrete items	22	17,511	(867)
Total (provision) benefit for income taxes	<u>\$ (12,660)</u>	<u>\$ 4,411</u>	<u>\$ (6,621)</u>
Net income	<u>\$ 19,581</u>	<u>\$ 37,193</u>	<u>\$ 11,645</u>
Basic earnings per common share	<u>\$ 1.18</u>	<u>\$ 2.25</u>	<u>\$ 0.64</u>
Diluted earnings per common share	<u>\$ 1.12</u>	<u>\$ 2.09</u>	<u>\$ 0.63</u>
Dividends declared per share	<u>\$ 0.15</u>	<u>\$ 0.225</u>	<u>\$ 0.30</u>
Weighted average number of common and common equivalent shares outstanding:			
Basic	<u>16,515</u>	<u>16,438</u>	<u>17,971</u>
Diluted	<u>17,460</u>	<u>17,715</u>	<u>18,374</u>

The accompanying notes are an integral part of these Consolidated Financial Statements.

CARRIAGE SERVICES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(in thousands)

	Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total
Balance – December 31, 2015	16,648	\$ 225	\$ 214,250	\$ 1,130	\$ (60,266)	\$ 155,339
Net Income – 2016	—	—	—	19,581	—	19,581
Issuance of common stock	45	—	872	—	—	872
Exercise of stock options	48	1	—	—	—	1
Issuance of restricted common stock	18	—	12	—	—	12
Cancellation and retirement of restricted common stock and stock options	(118)	(1)	(888)	—	—	(889)
Stock-based compensation expense	—	—	3,526	—	—	3,526
Dividends on common stock	—	—	(2,492)	—	—	(2,492)
Excess tax benefit on equity compensation	—	—	(216)	—	—	(216)
Balance – December 31, 2016	16,641	\$ 225	\$ 215,064	\$ 20,711	\$ (60,266)	\$ 175,734
Net Income – 2017	—	—	—	37,193	—	37,193
Issuance of common stock	68	1	1,637	—	—	1,638
Exercise of stock options	61	—	514	—	—	514
Issuance of restricted common stock	27	—	—	—	—	—
Cancellation and retirement of restricted common stock and stock options	(25)	—	(551)	—	—	(551)
Stock-based compensation expense	—	—	3,203	—	—	3,203
Dividends on common stock	—	—	(3,709)	—	—	(3,709)
Treasury stock acquired	(674)	—	—	—	(16,366)	(16,366)
Balance – December 31, 2017	16,098	\$ 226	\$ 216,158	\$ 57,904	\$ (76,632)	\$ 197,656
Effect of adoption of topic 606	—	—	—	2,131	—	2,131
Balance – January 1, 2018	16,098	\$ 226	\$ 216,158	\$ 60,035	\$ (76,632)	\$ 199,787
Net Income – 2018	—	—	—	11,645	—	11,645
Issuance of common stock	62	1	1,199	—	—	1,200
Exercise of stock options	140	1	(34)	—	—	(33)
Issuance of restricted common stock	87	1	24	—	—	25
Cancellation and retirement of restricted common stock and stock options	(30)	—	(398)	—	—	(398)
Stock-based compensation expense	—	—	6,531	—	—	6,531
Dividends on common stock	—	—	(5,514)	—	—	(5,514)
Convertible notes exchange	2,823	28	25,883	—	—	25,911
Treasury stock acquired	(1,102)	—	—	—	(17,662)	(17,662)
Balance – December 31, 2018	18,078	\$ 257	\$ 243,849	\$ 71,680	\$ (94,294)	\$ 221,492

The accompanying notes are an integral part of these Consolidated Financial Statements.

CARRIAGE SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Years Ended December 31,		
	2016	2017	2018
Cash flows from operating activities:			
Net income	\$ 19,581	\$ 37,193	\$ 11,645
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	15,421	15,979	17,430
Provision for losses on accounts receivable	2,098	2,198	1,841
Stock-based compensation expense	3,229	3,162	6,583
Deferred income tax expense (benefit)	4,855	(11,651)	3,823
Amortization of deferred financing costs	824	820	532
Amortization of capitalized commissions on preneed contracts	—	—	599
Accretion of discount on 2.75% convertible subordinated notes	3,870	4,329	2,192
Accretion of discount on 6.625% senior notes	—	—	272
Net loss on early extinguishment of debt	567	—	502
Net loss (gain) on sale of businesses and disposal of other assets	2,077	(710)	1,052
Impairment of intangible and other assets	145	—	1,019
Changes in operating assets and liabilities that provided (required) cash:			
Accounts and preneed receivables	(5,162)	(4,254)	(5,061)
Inventories and other current assets	1,995	1,446	(159)
Intangible and other non-current assets	(1,155)	149	(390)
Preneed funeral and cemetery trust investments	(14,528)	(10,008)	24,401
Accounts payable	2,112	(3,649)	2,044
Accrued and other liabilities	780	(385)	3,990
Deferred preneed funeral and cemetery revenue	(640)	1,446	6,546
Deferred preneed funeral and cemetery receipts held in trust	13,966	9,165	(29,867)
Net cash provided by operating activities	<u>50,035</u>	<u>45,230</u>	<u>48,994</u>
Cash flows from investing activities:			
Acquisitions and land for new construction	(26,556)	(28,799)	(37,970)
Purchase of land and buildings previously leased	(6,258)	—	—
Net proceeds from sale of businesses and other assets	4,385	5,731	—
Capital expenditures	(16,846)	(16,395)	(13,526)
Net cash used in investing activities	<u>(45,275)</u>	<u>(39,463)</u>	<u>(51,496)</u>
Cash flows from financing activities:			
Payments against the term loan	(11,250)	(11,250)	(127,500)
Borrowings from the credit facility	71,200	106,900	124,500
Payments against the credit facility	(96,100)	(82,600)	(189,400)
Borrowings from the term loan	39,063	—	—
Payment of debt issuance costs related to the credit facility	—	—	(1,751)
Acquisition of 2.75% convertible subordinated notes	—	—	(98,266)
Transaction costs related to the acquisition of 2.75% convertible subordinated notes	—	—	(885)
Proceeds from the issuance of the 6.625% senior notes	—	—	320,125
Payment of debt issuance costs related to the 6.625% senior notes	—	—	(1,367)
Payments on long-term debt and obligations under capital leases	(1,789)	(1,962)	(1,940)
Payments on contingent consideration recorded at acquisition date	—	(101)	(138)
Proceeds from the exercise of stock options and employee stock purchase plan contributions	870	1,496	1,246
Taxes paid on restricted stock vestings and exercises of non-qualified options	(578)	(509)	(651)
Dividends paid on common stock	(2,492)	(3,709)	(5,513)
Purchase of treasury stock	—	(16,366)	(16,266)
Payment of loan origination costs related to the credit facility	(717)	—	—
Excess tax deficiency of equity compensation	(216)	—	—
Net cash provided by (used in) financing activities	<u>(2,009)</u>	<u>(8,101)</u>	<u>2,194</u>
Net increase (decrease) in cash and cash equivalents	2,751	(2,334)	(308)
Cash and cash equivalents at beginning of year	535	3,286	952
Cash and cash equivalents at end of year	<u>\$ 3,286</u>	<u>\$ 952</u>	<u>\$ 644</u>

The accompanying notes are an integral part of these Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

Carriage Services, Inc. (“Carriage,” the “Company,” “we,” “us,” or “our”) is a leading provider of funeral and cemetery services and merchandise in the United States. At December 31, 2018, we operated 182 funeral homes in 29 states and 29 cemeteries in 11 states. Our operations are reported in two business segments: Funeral Home Operations, which currently accounts for approximately 80% of our revenue and Cemetery Operations, which currently accounts for approximately 20% of our revenue.

Our funeral homes offer a complete range of high value personal services to meet a family's funeral needs, including consultation, the removal and preparation of remains, the sale of caskets and related funeral merchandise, the use of funeral home facilities for visitation and remembrance services and transportation services. Our cemeteries provide interment rights (grave sites and mausoleum spaces) and related merchandise, such as markers and outer burial containers. We provide funeral and cemetery services and products on both an “atneed” (time of death) and “preneed” (planned prior to death) basis.

Principles of Consolidation

The accompanying Consolidated Financial Statements include the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated.

Reclassifications

Certain reclassifications have been made to prior period amounts to conform to the current period financial statement presentation with no effect on our previously reported results of operations, consolidated financial position, or cash flows except for the impact of adopting the new guidance on revenue recognition. See Notes 2 and 6 to the Consolidated Financial Statements included herein for additional information related to our adoption of the new revenue recognition standard on January 1, 2018.

Cash and Cash Equivalents

We consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Use of Estimates

The preparation of our Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. On an on-going basis, we evaluate our estimates and judgments, including those related to revenue recognition, realization of accounts receivable, goodwill, intangible assets, property and equipment and deferred tax assets and liabilities. We base our estimates on historical experience, third party data and assumptions that we believe to be reasonable under the circumstances. The results of these considerations form the basis for making judgments about the amount and timing of revenue and expenses, the carrying value of assets and the recorded amounts of liabilities. Actual results may differ from these estimates and such estimates may change if the underlying conditions or assumptions change. Historical performance should not be viewed as indicative of future performance, as there can be no assurance that our results of operations will be consistent from year to year.

Inventory

Inventory consists primarily of caskets, outer burial containers and cemetery monuments and markers and is recorded at the lower of its cost basis (determined by the specific identification method) or net realizable value.

Revenue Recognition - Funeral Home Operations

Our funeral home operations are principally service businesses that generate revenue from sales of burial and cremation services and related merchandise, such as caskets and urns. Funeral services include consultation, the removal and preparation of remains, the use of funeral home facilities for visitation and remembrance services and transportation services. We provide funeral services and products on both an atneed and preneed basis.

Funeral arrangements sold at the time of death are referred to as atneed funeral contracts. The performance obligation on these atneed contracts for both merchandise and services are bundled as a single performance obligation, as the performance of these obligations occur within a short time frame (usually within a few days) from the time of death to the funeral service. Although our performance activities are transferred in sequence such as, embalming the body, delivering the casket, obtaining service related items like flowers and performing the service, these are all essential to satisfy our contractual obligation to the customer, thus, bundled into a single performance obligation. Revenue is recognized on the date of funeral service, as all performance obligations

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

have been satisfied. Payment is due at or before time of transfer. Outstanding balances due from customers, if any, on atneed funeral contracts are included in *Accounts receivable* on our Consolidated Balance Sheet.

The performance obligation is satisfied at the date of the service or the delivery of the merchandise as control has transferred to the customer and the benefit has concluded in the following manner:

- we have the right to payment;
- the customer has title to merchandise;
- the deceased has used the merchandise or has been a part of the service; and
- the customer directed the use of the merchandise or the plan of the service.

Funeral arrangements sold prior to death occurring are referred to as preneed funeral contracts. In many instances, the customer pays for the preneed contract over a period of time. For preneed funeral merchandise and service contracts, the performance obligation occurs at the time of need (when death occurs) and revenue is recognized on the date of delivery of merchandise or performance of service. We do not deliver merchandise on preneed contracts or provide service prior to the time of death. The performance obligation for preneed funeral contracts is similar to the elements of the performance obligation of atneed funeral contracts. For preneed funeral services, all preneed funeral contracts are re-written upon the date of death as an atneed contract. The performance obligation is satisfied at the date of the service.

The performance of a preneed funeral contract is secured by placing the funds collected, less amounts that we may retain under state regulations, in trust for the benefit of the customer or by the customer's purchase of a life insurance policy, the proceeds of which will pay for such services at the time of need. These methods are intended to fund preneed funeral contracts, cover the original contract price and generally include an element of growth (earnings) designed to offset future inflationary cost increases.

Revenue from preneed funeral contracts, along with accumulated earnings, is deferred until the time the merchandise is delivered or the service is performed. The principal and accumulated earnings of the trusts are withdrawn at maturity (death) or cancellation. The cumulative trust income earned and the increases in insurance benefits on the insurance products are recognized when the service is performed. The amounts deposited in trusts that we control are included in the non-current asset section of our Consolidated Balance Sheet. Beginning January 1, 2018, balances due on undelivered preneed funeral trust contracts have been reclassified to reduce *Deferred preneed funeral revenue* on our Consolidated Balance Sheet, as noted in our table of Deferred Revenue in Note 6 to the Consolidated Financial Statements included herein. See Note 2 to the Consolidated Financial Statements included herein for additional information related to our adoption of the new revenue recognition standard on January 1, 2018.

The earnings from our preneed funeral trust investments, as well as trust management fees charged by our wholly-owned registered investment advisory firm ("CSV RIA") are recorded as *Other revenue*, as noted in our table of disaggregated revenue in Note 6 to the Consolidated Financial Statements included herein. As of December 31, 2018, CSV RIA provided these services to one institution, which has custody of 75% of our trust assets, for a fee based on the market value of trust assets. Under state trust laws, we are allowed to charge the trust a fee for advising on the investment of the trust assets and these fees are recognized as income in the period in which services are provided.

When preneed funeral contracts are funded through third-party insurance policies, we earn a commission on the sale of the policies. Insurance commissions are subject to refund (charge-back) if the preneed policy is cancelled within a year or if there is an imminent death of beneficiary before the first year anniversary of the policy. We record these insurance commissions as *Other revenue*, as noted in our table of disaggregated revenue in Note 6 to the Consolidated Financial Statements included herein, when the commission is no longer subject to refund, which is typically one year after the policy is issued. All selling costs incurred pursuant to the sale of the insurance funded preneed contracts are expensed as incurred. Preneed funeral contracts to be funded at maturity by third-party insurance policies are not recorded as assets or liabilities on our Consolidated Balance Sheet. See Note 10 to the Consolidated Financial Statements included herein for additional information regarding estimated revenue associated with preneed funeral contracts funded by third-party insurance policies.

Generally, at the time of the sale of either the preneed insurance or preneed trust contract, the intent is that the beneficiary has made a commitment to assign the proceeds to us for the fulfillment of the service and merchandise obligations on the preneed contract at the time of need. However, this commitment is revocable and the proceeds from the policy are portable, so the customer can choose to use an alternative provider at the time of need.

Revenue Recognition - Cemetery Operations

Our cemetery operations generate revenue primarily through sales of cemetery interment rights (primarily grave sites, lawn crypts, mausoleum spaces and niches), related cemetery merchandise (such as outer burial containers, memorial markers and floral placements) and services (interments, inurnments and installation of cemetery merchandise). We provide cemetery services and products on both an atneed and preneed basis.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Cemetery arrangements sold at the time of death are referred to as atneed cemetery contracts. The performance obligation on these atneed contracts for cemetery property, merchandise and services are distinct. The performance obligations from the time of death to the disposition of the remains, include delivering cemetery property, unearthing the ground, interring remains and installing merchandise on the cemetery grounds. Each item on the contract is recognized as a distinct good or service. The performance obligation is satisfied and revenue is recognized on the purchase date of the interment right, on the date of the cemetery service, and on the date of delivery of the merchandise (set on cemetery grounds). Payment is due at or before time of transfer. Outstanding balances due from customers, if any, on completed atneed contracts are included in *Accounts receivable* on our Consolidated Balance Sheet.

The performance obligation is satisfied at the date of the service, the purchase of the interment right or the delivery of the merchandise as control has transferred to the customer and the benefit has concluded in the following manner:

- we have the right to payment;
- the customer has title to merchandise;
- the deceased has used the merchandise or has been a part of the service; and
- the customer directed the use of the merchandise or the plan of the service.

Cemetery arrangements sold prior to death occurring are referred to as preneed cemetery contracts. For preneed cemetery interment rights, the performance obligation is the sale of the interment right and revenue is recognized at the time the contract is signed. Control of cemetery interment rights is transferred to the customer upon execution of the contract as customers select a specific location and space for their interment right, thus, restricting us from other use or transfer of the contracted cemetery property. The interment right is deeded to the customer when the contract is paid in full.

For preneed cemetery merchandise and service, the performance obligation occurs at the time of need (when death occurs) and revenue is recognized on the date of delivery of merchandise or performance of service. We do not deliver merchandise on preneed contracts or provide service prior to the time of death. The performance obligation for preneed cemetery merchandise and service is similar to the elements of the performance obligation of atneed cemetery merchandise and service.

Preneed cemetery contracts are usually financed through interest-bearing installment sales contracts, generally with terms of up to five years. In substantially all cases, we receive an initial down payment at the time the contract is signed. Earnings on these installment contracts are not recognized until the time the merchandise is transferred or the service is performed and are recorded as *Other revenue*, as noted in our table of disaggregated revenue in Note 6 to the Consolidated Financial Statements included herein.

The performance of the preneed cemetery contracts is secured by placing the funds collected, less amounts that we may retain under state regulations, in trust for the benefit of the customer, the proceeds of which will pay for such services at the time of need. This method is intended to fund preneed contracts, cover the original contract price and generally include an element of growth (earnings) designed to offset future inflationary cost increases. The amounts deposited in trusts that we control are included in the non-current asset section of our Consolidated Balance Sheet. The earnings from preneed cemetery contracts placed in trust, as well as the trust management fees charged by our CSV RIA are recorded as *Other revenue*, as noted in our table of disaggregated revenue in Note 6 to the Consolidated Financial Statements included herein.

Balances due from customers on delivered preneed cemetery contracts are included in *Accounts receivable* and *Preneed receivables* on our Consolidated Balance Sheet. Beginning January 1, 2018, balances due on undelivered preneed cemetery contracts have been reclassified to reduce *Deferred preneed cemetery revenue* on our Consolidated Balance Sheet, as noted in our table of *Deferred Revenue* in Note 6 to the Consolidated Financial Statements included herein. See Note 2 to the Consolidated Financial Statements included herein for additional information related to our adoption of the new revenue recognition standard on January 1, 2018.

We sell memorialization merchandise and personalized marker merchandise, such as urns and markers that are supplied by a small number of national providers. We order the memorialized merchandise through a third-party on behalf of our customer. The merchandise and its memorialization is provided by the third-party. We deliver the merchandise after the time of death to the customer upon completion of the memorialization or we set the merchandise on our cemetery grounds.

Interment right costs, which include real property and other costs related to cemetery development, are expensed using the specific identification method in the period in which the sale of the interment right is recognized as revenue. We recorded amortization expense for cemetery interment rights of \$3.9 million, \$3.3 million and \$3.6 million for the years ended December 31, 2016, 2017 and 2018, respectively.

See Note 6 to the Consolidated Financial Statements included herein for additional information on our revenue.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Arrangements with Multiple Performance Obligations

Some of our contracts with customers include multiple performance obligations. For these contracts, we allocate transaction price to each performance obligation based on its relative standalone selling price, which is based on prices charged to customers per our general price list. Packages for service and ancillary items are offered to help the customer make decisions during emotional/stressful times. Package discounts are reflected net in *Revenue*. We recognize revenue when the merchandise is transferred or the service is performed, in satisfaction of the corresponding performance obligation. Sales taxes collected are recognized on a net basis in our Consolidated Financial Statements.

Preneed Funeral and Cemetery Trust Funds

Our preneed and perpetual care trust funds are reported in accordance with the principles of consolidating Variable Interest Entities (“VIE’s”). In the case of preneed trusts, the customers are the legal beneficiaries. In the case of perpetual care trusts, we do not have a right to access the corpus in the perpetual care trusts. We have recognized financial interests of third parties in the trust funds in our financial statements as *Deferred preneed funeral and cemetery receipts held in trust* and *Care trusts’ corpus*. The investments of such trust funds are classified as available-for-sale and are reported at fair market value; therefore, the unrealized gains and losses, as well as accumulated and undistributed income and realized gains and losses are recorded to *Deferred preneed funeral and cemetery receipts held in trust* and *Care trusts’ corpus* on our Consolidated Balance Sheet. Our future obligations to deliver merchandise and services are reported at estimated settlement amounts. Preneed funeral and cemetery trust investments are reduced by the trust investment earnings that we have been allowed to withdraw in certain states prior to maturity. These earnings, along with preneed contract collections not required to be placed in trust, are recorded in *Deferred preneed funeral revenue* and *Deferred preneed cemetery revenue* until the service is performed or the merchandise is delivered.

In accordance with respective state laws, we are required to deposit a specified amount into perpetual and memorial care trust funds for each interment right and certain memorials sold. Income from the trust funds is distributed to us and used to provide for the care and maintenance of the cemeteries and mausoleums. Such trust fund income is recognized as revenue when realized by the trust and distributable to us. We are restricted from withdrawing any of the principal balances of these funds.

An enterprise is required to perform an analysis to determine whether the enterprise’s variable interest(s) give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has both the power to direct the activities of the VIE that most significantly impact the entity’s economic performance and the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. Our analysis continues to support our position as the primary beneficiary in the majority of our funeral and cemetery trust funds.

We determine whether or not the assets in the preneed trusts have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis of the investment due to an other-than-temporary impairment is likewise recorded as a reduction to *Deferred preneed funeral and cemetery receipts held in trust* and *Care trusts’ corpus* on our Consolidated Balance Sheet. There will be no impact on earnings unless and until such time that the investment is withdrawn from the trust in accordance with state regulations at an amount that is less than its original basis.

See Notes 7, 9 and 11 to the Consolidated Financial Statements herein for additional information related to our trust funds.

Allowance for bad debts and customer cancellations

Our funeral receivables recorded in *Accounts Receivable, net* primarily consist of amounts due for funeral services already performed which were \$8.5 million at both December 31, 2017 and December 31, 2018, respectively. We estimate an allowance for doubtful accounts on these receivables based on our historical experience and we monitor changes in delinquency rates and provide additional bad debt and cancellation reserves when warranted. Our allowance for funeral receivables was 2.5% and 2.2% at December 31, 2017 and December 31, 2018, respectively. In addition, our other funeral receivables not related to funeral services performed were \$0.8 million and \$0.7 million at December 31, 2017 and December 31, 2018, respectively.

Our cemetery financed receivables totaled \$40.5 million and \$37.2 million at December 31, 2017 and December 31, 2018, respectively. The unearned finance charges associated with these receivables were \$5.7 million and \$4.6 million at December 31, 2017 and December 31, 2018, respectively. If a preneed contract is canceled prior to delivery, state law determines the amount of the refund owed to the customer. Allowances for bad debts and customer cancellations on cemetery financed receivables are recorded at the date that the sale is recognized as revenue and are based on our historical experience. We also monitor changes in delinquency rates and provide additional bad debt and cancellation reserves when warranted. We have a collections policy where past due notifications are sent to the customer beginning at 15 days past due and periodically thereafter until the contract is cancelled or payment is received. We reserve 100% of the receivables on contracts in which the revenue has been recognized and payments

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

are 90 days past due or more, which was approximately 4.9% and 4.6% of the total receivables at December 31, 2017 and December 31, 2018, respectively. See Note 8 to the Consolidated Financial Statements included herein for additional information on cemetery financed receivables.

Our cemetery receivables recorded in *Accounts Receivable, net* also include \$1.3 million and \$1.8 million related to perpetual care income receivables at December 31, 2017 and December 31, 2018, respectively. See Note 11 to the Consolidated Financial Statements included herein for additional information on our perpetual care trust investments.

Accounts receivable was comprised of the following at December 31, 2017 and December 31, 2018 (in thousands):

	<u>December 31, 2017</u>	<u>December 31, 2018</u>
Funeral receivables, net of allowance for bad debt of \$213 and \$189, respectively	\$ 9,061	\$ 9,002
Cemetery receivables, net of allowance for bad debt of \$622 and \$580, respectively	10,331	9,688
Other receivables	263	207
Accounts receivable, net	<u>\$ 19,655</u>	<u>\$ 18,897</u>

Non-current preneed receivables represent payments expected to be received beyond one year from the balance sheet date. Preneed receivables were comprised of the following at December 31, 2017 and December 31, 2018 (in thousands):

	<u>December 31, 2017</u>	<u>December 31, 2018</u>
Funeral receivables, net of allowance for bad debt of \$882	\$ 7,934	\$ —
Cemetery receivables, net of allowance for bad debt of \$1,396 and \$1,228, respectively	23,710	18,441
Preneed receivables, net	<u>\$ 31,644</u>	<u>\$ 18,441</u>

Bad debt expense totaled \$2.1 million, \$2.2 million and \$1.8 million for the years ended December 31, 2016, 2017 and 2018, respectively.

Capitalized Commissions on Preneed Contracts

Effective January 1, 2018, we adopted the Financial Accounting Standards Board's ("FASB") Accounting Standards Update ("ASU"), *Revenue from Contracts with Customers (Topic 606)*, which impacted our accounting for incremental selling costs, primarily commission costs, related to preneed cemetery merchandise and services and preneed funeral trust contracts.

Upon adoption of Topic 606, we capitalize sales commissions and other direct selling costs related to preneed cemetery merchandise and services and preneed funeral trust contracts as these costs are incremental and recoverable costs of obtaining a contract with a customer. We recorded a cumulative net adjustment of \$2.1 million to *Retained earnings* on our opening Consolidated Balance Sheet on January 1, 2018. See Note 2 to the Consolidated Financial Statements included herein for additional information regarding our opening balance sheet adjustment. Our capitalized commissions on preneed contracts are amortized on a straight-line basis over the average maturity period for our preneed cemetery merchandise and services contracts and preneed funeral trust contracts, of eight and ten years, respectively. Amortization expense totaled \$0.6 million for the year ended December 31, 2018. There were no impairment losses recognized for the year ended December 31, 2018.

See Note 2 to the Consolidated Financial Statements included herein for additional information related to our adoption of the new revenue recognition standard on January 1, 2018. See Note 13 to the Consolidated Financial Statements included herein for additional information regarding our capitalized commissions on preneed contracts.

On September 30, 2018, our management agreement with a Florida municipality expired and as a result, we ceased to operate three of our cemetery businesses. We recorded a loss of approximately \$125,000 in *Other, net*, for the write-off of capitalized commissions related to these three cemetery businesses. See Note 5 to the Consolidated Financial Statements included herein for additional information regarding the expired management agreement for these three cemetery businesses.

The selling costs related to the sales of cemetery interment rights, which include real property and other costs related to cemetery development activities, continue to be expensed using the specific identification method in the period in which the sale of the cemetery interment right is recognized as revenue. The selling costs related to preneed funeral insurance contracts continue to be expensed in the period incurred as these contracts are not included on our Consolidated Balance Sheet.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Property, Plant and Equipment

Property, plant and equipment (including equipment under capital leases) are stated at cost. The costs of ordinary maintenance and repairs are charged to operations as incurred, while renewals and major replacements that extend the useful economic life of the asset are capitalized. Depreciation of property, plant and equipment (including equipment under capital leases) is computed based on the straight-line method over the following estimated useful lives of the assets:

	Years
Buildings and improvements	15 to 40
Furniture and fixtures	5 to 10
Machinery and equipment	3 to 15
Automobiles	5 to 7

Property, plant and equipment was comprised of the following at December 31, 2017 and 2018 (in thousands):

	December 31, 2017	December 31, 2018
Land	\$ 74,981	\$ 81,012
Buildings and improvements	211,934	223,646
Furniture, equipment and automobiles	76,155	81,125
Property, plant and equipment, at cost	363,070	385,783
Less: accumulated depreciation	(115,776)	(124,945)
Property, plant and equipment, net	\$ 247,294	\$ 260,838

Depreciation expense was \$11.5 million, \$12.6 million and \$13.8 million for the years ended December 31, 2016, 2017 and 2018, respectively. We acquired \$17.5 million of property, plant and equipment in connection with the four funeral home businesses we acquired during 2018, as further discussed in Note 3 to the Consolidated Financial Statements included herein.

During 2017, we acquired real estate for \$1.3 million for funeral home expansion projects. In addition, we acquired \$12.2 million of property, plant and equipment in connection with the seven funeral home businesses we acquired during 2017.

Long-lived assets, such as property, plant and equipment subject to depreciation and amortization, are reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with the Property, Plant and Equipment topic of the Accounting Standards Codification (“ASC”) 360. This guidance requires that long-lived assets to be held and used are reported at the lower of their carrying amount or fair value. We assess long-lived assets for impairment whenever events or circumstances indicate that the carrying value may be greater than the fair value. We evaluate our long-lived assets for impairment when a funeral home or cemetery business has negative earnings before interest, taxes, depreciation and amortization (“EBITDA”) for four consecutive years and if there has been a decline in EBITDA in that same period. We review our long-lived assets deemed held-for-sale to the point of recoverability. Assets to be disposed of and assets not expected to provide any future service potential are recorded at the lower of their carrying amount or fair value less estimated cost to sell. If we determine that the carrying value is not recoverable from the proceeds of the sale, we record an impairment at that time.

During 2018, we recorded an impairment of \$0.2 million related to the real property of a funeral home business held for sale, as the carrying value exceeded fair value. For the years ended December 31, 2016 and 2017, no impairments were identified on our long-lived assets.

Business Combinations

Tangible and intangible assets acquired and liabilities assumed are recorded at fair value and goodwill is recognized for any difference between the price of the acquisition and fair value. We recognize the assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at the acquisition date, measured at the fair value as of that date. Acquisition related costs are recognized separately from the acquisition and are expensed as incurred. We customarily estimate related transaction costs known at closing. To the extent that information not available to us at the closing date subsequently becomes available during the allocation period, we may adjust goodwill, intangible assets, assets or liabilities associated with the acquisition.

During 2018, we acquired four funeral home businesses. In July 2018, we acquired one funeral home business in Fredericksburg, Virginia and one funeral home business in Stafford, Virginia. In August 2018, we acquired one funeral home business in Cookeville, Tennessee and one funeral home business in Knightdale, North Carolina.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

During 2017, we acquired seven funeral home businesses. We acquired one funeral home business in Longmont, Colorado and one funeral home business in Loveland, Colorado in November 2017 and five funeral home businesses on Long Island, New York in December 2017.

The pro forma impact of the acquisitions on prior periods is not presented as the impact is not material to our reported results. The results of the acquired businesses are included in our results of operations from the date of acquisition.

See Note 3 to the Consolidated Financial Statements herein for further information concerning these acquisitions.

Goodwill

The excess of the purchase price over the fair value of identifiable net assets of funeral home businesses acquired is recorded as goodwill. Goodwill has primarily been recorded in connection with the acquisition of funeral home businesses. Goodwill has an indefinite life and is not subject to amortization. As such, we test goodwill for impairment on an annual basis. Our intent is to perform a quantitative impairment test at least once every three years unless certain indicators or events suggest otherwise and perform a qualitative assessment during the remaining two years.

Our quantitative goodwill impairment test involves estimates and management judgment. In the quantitative analysis, we compare the fair value of each reporting unit to its carrying value, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, the goodwill of that reporting unit is not considered impaired. We determine fair value for each reporting unit using both an income approach, weighted 90%, and a market approach, weighted 10%. Our methodology for determining an income-based fair value is based on discounting projected future cash flows. The projected future cash flows include assumptions concerning future operating performance and economic conditions that may differ from actual future cash flows discounted at our weighted average cost of capital based on market participant assumptions. Our methodology for determining a market approach fair value utilizes the guideline public company method, in which we rely on market multiples of comparable companies operating in the same industry as the individual reporting units. In accordance with the guidance, if the fair value of the reporting unit is less than its carrying amount an impairment charge is recorded in an amount equal to the difference.

For our 2018 annual impairment test, we performed a qualitative assessment, using information as of August 31, 2018. Under current guidance, we are permitted to first assess qualitative factors to determine whether it is more-likely-than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a quantitative goodwill impairment test. We determined that there were no factors that would indicate the need to perform a quantitative goodwill impairment test and concluded that it is more-likely-than not that the fair value of our reporting units is greater than their carrying value and thus there was no impairment to goodwill.

For our 2017 annual impairment test, we performed a qualitative assessment and concluded that the fair value of our reporting units was greater than their carrying value and thus there was no impairment to goodwill.

In addition to our annual review, we assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value of a reporting unit may be greater than fair value. Factors that could trigger an interim impairment review include, but are not limited to, significant adverse changes in the business climate which may be indicated by a decline in our market capitalization or decline in operating results.

During 2018, we recorded an impairment of \$0.8 million related to a funeral home business that we intend to cease operating in 2019, as the carrying value exceeded fair value. No impairments were recorded to our goodwill during the years ended December 31, 2016 and 2017. No such events or changes occurred between the testing date and year end to trigger a subsequent impairment review.

See Note 4 to the Consolidated Financial Statements herein for additional information related to our goodwill.

Intangible Assets

Our intangible assets include tradenames resulting from acquisitions and are included in *Intangible and other non-current assets* on our Consolidated Balance Sheet. Our tradenames are considered to have an indefinite life and are not subject to amortization. As such, we test our intangible assets for impairment on an annual basis. Our intent is to perform a quantitative impairment test at least once every three years unless certain indicators or events suggest otherwise and perform a qualitative assessment during the remaining two years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Our quantitative intangible asset impairment test involves estimates and management judgment. Our quantitative analysis is performed using the relief from royalty method, which measures the tradenames by determining the value of the royalties that we are relieved from paying due to our ownership of the asset. We determine the fair value of the asset by discounting the cash flows that represent a savings in lieu of paying a royalty fee for use of the tradename. The discounted cash flow valuation uses projections of future cash flows and includes assumptions concerning future operating performance and economic conditions that may differ from actual future cash flows and the determination and application of an appropriate royalty rate and discount rate. To estimate the royalty rates for the individual tradename, we mainly rely on the profit split method, but also consider the comparable third-party license agreements and the return on asset method. A scorecard is used to assess the relative strength of the individual tradename to further adjust the royalty rates selected under the profit-split method for qualitative factors. In accordance with the guidance, if the fair value of the tradename is less than its carrying amount an impairment charge is recorded in an amount equal to the difference.

For our 2018 annual impairment test, we performed a qualitative assessment, using information as of August 31, 2018. Under current guidance, we are permitted to first assess qualitative factors to determine whether it is more-likely-than not that the fair value of the tradename is less than its carrying amount as a basis for determining whether it is necessary to perform a quantitative impairment test. We determined that there were no factors that would indicate the need to perform a quantitative impairment test and concluded that it is more likely than not that the fair value of our intangible assets is greater than its carrying value and thus there was no impairment to our intangible assets.

For our 2017 annual impairment test, we performed a qualitative assessment and concluded that the fair value of our intangible assets was greater than its carrying value and thus there was no impairment to our intangible assets.

In addition to our annual review, we assess the impairment of intangible assets whenever certain events or changes in circumstances indicate that the carrying value of the intangible asset may be greater than the fair value. Factors that could trigger an interim impairment review include, but are not limited to, significant under-performance relative to historical or projected future operating results and significant negative industry or economic trends. During 2016, we recorded an impairment to tradenames of \$145,000 related to a funeral home business held for sale as the carrying value exceeded fair value. No other impairments were recorded to our intangible assets during the years ended December 31, 2016, 2017 and 2018.

See Note 13 to the Consolidated Financial Statements included herein for additional information on our intangible assets.

Divested Operations

During 2018, our management agreement with a Florida municipality expired and as a result, we ceased to operate three of our cemetery businesses. During 2017, we sold a funeral home business in Kentucky for \$0.6 million and during 2016, we sold a funeral home business in Tennessee for \$1.35 million. The operating results of these divested businesses are reflected in our Consolidated Statements of Operations.

We continually review locations to optimize the sustainable earning power and return on our invested capital. These reviews could entail selling certain non-strategic businesses.

See Note 5 to the Consolidated Financial Statements herein for additional information concerning our divested businesses.

Fair Value Measurements

We measure the available-for-sale securities held by our funeral merchandise and service, cemetery merchandise and service, and cemetery perpetual care trusts at fair value on a recurring basis in accordance with the Fair Value Measurements Topic of the ASC. This guidance defines fair value as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The guidance establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets;
- Level 2 — inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and
- Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

We disclose the extent to which fair value is used to measure financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date. The fair value disclosures of transfers in and out of Levels 1 and 2 and the gross presentation of

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

purchases, sales, issuances and settlements in the Level 3 reconciliation of the three-tier fair value hierarchy are also presented in Notes 7 and 11 to the Consolidated Financial Statements included herein. We currently do not have any assets that have fair values determined by Level 3 inputs and no liabilities measured at fair value. We have not elected to measure any additional financial instruments and certain other items at fair value that are not currently required to be measured at fair value.

To determine the fair value of assets and liabilities in an environment where the volume and level of activity for the asset or liability have significantly decreased, the exit price is used as the fair value measurement. For the year ended December 31, 2018, we did not incur significant decreases in the volume or level of activity of any asset or liability. We consider an impairment of debt and equity securities other-than-temporary unless (a) we have the ability and intent to hold an investment and (b) evidence indicating the cost of the investment is recoverable before we are more likely than not required to sell the investment. If an impairment is indicated, then an adjustment is made to reduce the carrying amount to fair value which is recorded as a reduction to either *Deferred preneed cemetery receipts held in trust*, *Deferred preneed funeral receipts held in trust* or *Care trusts' corpus* on our Consolidated Balance Sheet. We did not record any impairments during the year ended December 31, 2017 and 2018.

In the ordinary course of business, we are typically exposed to a variety of market risks. Currently, these are primarily related to changes in fair market values related to outstanding debts and changes in the values of securities associated with the preneed and perpetual care trusts. Management is actively involved in monitoring exposure to market risk and developing and utilizing risk management techniques when appropriate and when available for a reasonable price.

See Notes 7, 11 and 12 to the Consolidated Financial Statements herein for additional required disclosures concerning the fair value measurement of our financial assets and liabilities.

Income Taxes

We and our subsidiaries file a consolidated U. S. federal income tax return, separate income tax returns in 16 states in which we operate and combined or unitary income tax returns in 13 states in which we operate. We record deferred taxes for temporary differences between the tax basis and financial reporting basis of assets and liabilities. We classify our deferred tax liabilities and assets as non-current on our Consolidated Balance Sheet.

We record a valuation allowance to reflect the estimated amount of deferred tax assets for which realization is uncertain. Management reviews the valuation allowance at the end of each quarter and makes adjustments if it is determined that it is more likely than not that the tax benefits will be realized.

We analyze tax benefits for uncertain tax positions and how they are to be recognized, measured, and derecognized in the financial statements; provide certain disclosures of uncertain tax matters; and specify how reserves for uncertain tax positions should be classified on our Consolidated Balance Sheet.

On May 10, 2017, we filed amended federal returns for the tax years ending December 31, 2013, 2014 and 2015, which generated significant refunds. As a result, on July 18, 2017, we received notification that the Internal Revenue Service (“IRS”) selected our tax years ended December 31, 2013, 2014 and 2015 for a limited scope examination to verify the refunds due. The examinations are in progress, however, the timing of the conclusion of the audit is uncertain.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (“the Tax Act”). The Tax Act makes broad and complex changes to the U.S. tax code. Effective as of January 1, 2018, the Tax Act established new tax laws, including but not limited to (1) a reduction of the corporate tax rate from a top marginal rate of 35% to a flat rate of 21%; (2) a limitation of the tax deduction for interest expense to 30% of adjusted earnings; (3) a limitation of the deduction for net operating losses to 80% of current year taxable income and elimination of net operating loss carrybacks; (4) limitations of certain executive compensation deductions; and (5) limitations or repeals of many business deductions and credits.

The analysis required by Staff Accounting Bulletin (“SAB”) 118 to determine the impact of the Tax Act was complete as of December 31, 2017. Return to provision adjustments recorded in the fourth quarter of 2018 resulted in additional favorable impact from the rate reduction as there were changes to the deferred balances recorded.

On December 21, 2018, we filed 3 Form 3115s, Application for Change in Accounting Method, and associated statements with the requesting consent to change the method of accounting for deferred revenue for our cemetery property and cemetery merchandise and service operations for the taxable year beginning January 1, 2018 and ending December 31, 2018. The application requesting a change in the method of accounting for recognizing advance payments received under preneed contracts for cemetery services and merchandise is to comply with Internal Revenue Code (I.R.C.) Sections 61, 451, and 471. The change in method of accounting for constructed and unconstructed cemetery property is to comply with I.R.C Sections 61, 451, 1001, 1012 and 460. The method changes filed are non-automatic and require IRS approval. The impact of the change in the method of accounting for deferred revenue will be recorded in the interim period in which the method changes are approved. The method changes are expected to be approved, but the timing of the approval is uncertain. Additionally, once approved the method changes will result in significant favorable deductions and will have a favorable impact on cash taxes paid during 2019.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

We do not have any unrecognized tax benefits recorded as of December 31, 2018 and we do not anticipate a material change in our unrecognized tax benefits during the next twelve months.

See Note 18 to the Consolidated Financial Statements included herein for additional information concerning our income taxes.

Stock Plans and Stock-Based Compensation

We have stock-based employee and director compensation plans under which we grant stock, restricted stock, stock options and performance awards. We also have an employee stock purchase plan (“ESPP”). We recognize compensation expense in an amount equal to the fair value of the stock-based awards expected to vest or to be purchased over the requisite service period.

Fair value is determined on the date of the grant. The fair value of restricted stock is determined using the stock price on the grant date. The fair value of options or awards containing options is determined using the Black-Scholes valuation model. The fair value of the performance awards related to market performance is determined using a Monte-Carlo simulation pricing model. The fair value of the performance awards related to internal performance metrics is determined using the stock price on the grant date. The fair value of the ESPP is determined based on the discount element offered to employees and the embedded option element, which is determined using an option calculation model.

We recognize all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) as income tax expense or benefit in the income statement. We treat the tax effects of exercised or vested awards as discrete items in the reporting period in which they occur. For the years ended December 31, 2017 and 2018, the excess tax deficiency related to share-based payments was approximately \$0.1 million and \$0.8 million, respectively, recorded within *Tax adjustment related to certain discrete items* on our Consolidated Statements of Operations. Excess tax benefits or deficiencies related to share-based payments are included in operating cash flows.

Amounts withheld from restricted stock vestings and stock option exercises for the purpose of paying employee related taxes are presented as financing activities on our Consolidated Statement of Cash Flows. For the years ended December 31, 2016, 2017 and 2018, we withheld shares to pay employee taxes in the amount of \$0.6 million, \$0.5 million and \$0.7 million. Prior to January 1, 2017, these amounts were presented as operating activities on our Consolidated Statement of Cash Flows.

See Note 19 to the Consolidated Financial Statements included herein for additional information on our stock-based compensation plans.

Computation of Earnings Per Common Share

Basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period. Dilutive common equivalent shares consist of stock options and our Convertible Notes (as defined in Note 14).

Share-based awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are recognized as participating securities and included in the computation of both basic and diluted earnings per share. Our grants of restricted stock awards to our employees and directors are considered participating securities, and we have prepared our earnings per share calculations attributable to common stockholders to exclude outstanding unvested restricted stock awards, using the two-class method, in both the basic and diluted weighted average shares outstanding calculation.

The fully diluted weighted average shares outstanding for the years ended December 31, 2016, 2017 and 2018, and the corresponding calculation of fully diluted earnings per share, included 0.5 million, 0.9 million and 0.3 million shares that would have been issued upon the conversion of our Convertible Notes as a result of the application of the if-converted method prescribed by the FASB ASC 260.

See Note 21 to the Consolidated Financial Statements included herein for the computation of per share earnings for the fiscal years ended December 31, 2016, 2017 and 2018.

Correction of Immaterial Error

During the year ended December 31, 2017, we corrected an immaterial error related to 2013. The adjustment related to the correction of the deferred tax liability for the difference in book and tax basis of certain assets. The error had the impact of understating the deferred tax liability and overstating net income in 2013. Management evaluated the effect of the adjustment on previously issued interim and annual consolidated financial statements in accordance with the SEC's SAB No. 99 and SAB 108 and concluded that it was immaterial to the interim and annual periods. As a result, in accordance with SAB No. 108, we corrected our Consolidated Balance Sheet as of January 1, 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The effect of this adjustment on our Consolidated Balance Sheet as of December 31, 2017 was as follows (dollars in thousands):

		December 31, 2017	
			% Change
Increase in Deferred tax liability	\$	2,255	7.8%
Increase in Total liabilities	\$	2,255	0.3%
Decrease in Retained earnings	\$	2,255	3.7%
Decrease in Total stockholders' equity	\$	2,255	1.1%

This adjustment had no impact on our Consolidated Statements of Operations or Consolidated Statement of Cash Flows for the year ended December 31, 2017.

Related Party Transactions

Management evaluated reportable events and transactions that occurred between us and related persons during the year ended December 31, 2018. See Note 26 to the Consolidated Financial Statements included herein for additional information on our related party transactions.

Subsequent Events

We have evaluated events and transactions during the period subsequent to December 31, 2018 through the date the financial statements were issued for potential recognition or disclosure in the accompanying financial statements covered by this report.

2. RECENTLY ISSUED ACCOUNTING STANDARDS

Revenue Recognition

In May 2014, the FASB issued ASU, *Revenue from Contracts with Customers (Topic 606)*. FASB ASC Topic 606 supersedes the revenue recognition requirements under Topic 605, *Revenue Recognition*, and most industry-specific guidance throughout the Industry Topics of the ASC. The core principle of the guidance is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. Under Topic 606, an entity is required to perform the following five steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. Additionally, the guidance requires improved disclosures as to the nature, amount, timing and uncertainty of revenue that is recognized.

We adopted the provisions of this ASU on January 1, 2018 using the modified retrospective approach. As such, the comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

Topic 606 did not materially affect the accounting for our revenue streams. Revenue from sales of preneed cemetery interment rights was previously recognized in the period in which the customer's cumulative payments exceeded 10% of the contract price related to the interment right. Under Topic 606, we recognize revenue at the time the contract is signed. Customers select a specific location and space for their interment right, thus, restricting us from other use or transfer of the contracted cemetery property. The interment right is deeded to the customer when the contract is paid in full. Because we generally receive an initial down payment at the time the contract is signed, there is no significant difference in the timing of revenue recognition under Topic 606, as compared to previous guidance. Revenue from preneed sales of funeral and cemetery merchandise and services continues to be deferred and recognized when the merchandise is delivered or the service is performed.

Topic 606 impacted our accounting for incremental selling costs, primarily commission costs, related to preneed cemetery merchandise and services and preneed funeral trust contracts. Under Topic 606, these costs are capitalized and amortized over the average maturity period for our preneed cemetery contracts and preneed funeral trust contracts. Previously, these costs were expensed in the period incurred. Our capitalized commissions on preneed contracts are included in *Intangible and other non-current assets* on our Consolidated Balance Sheet. See Note 13 to the Consolidated Financial Statements included herein for additional information.

The selling costs related to the sales of cemetery interment rights, which include real property and other costs related to cemetery development activities, continue to be expensed using the specific identification method in the period in which the sale of the cemetery interment right is recognized as revenue. The selling costs related to preneed funeral insurance contracts continue to be expensed in the period incurred as these contracts are not included on our Consolidated Balance Sheet.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Topic 606 also impacted our classification of amounts due from customers for undelivered performance obligations. Under Topic 606 amounts due on our preneed funeral trust contracts and preneed cemetery merchandise and services contracts have been reclassified to reduce amounts reported as *Deferred preneed funeral revenue* and *Deferred preneed cemetery revenue*, respectively, on our Consolidated Balance Sheet. These amounts were previously reported as *Accounts receivable* and *Preneed receivables* on our Consolidated Balance Sheet.

The adoption of the provisions of this ASU did not have a material impact on our effective tax rate for the reporting period.

The following table presents the impact of the adoption of Topic 606 on our Consolidated Balance Sheet (in thousands):

	As of December 31, 2018		
	As Reported	Balances Without Adoption of Topic 606	Effect of Change
Assets			
Accounts receivable, net of allowance for bad debts	\$ 18,897	\$ 20,267	\$ (1,370)
Preneed receivables, net of allowance for bad debts	\$ 18,441	\$ 29,825	\$ (11,384)
Intangible and other non-current assets	\$ 2,717	\$ —	\$ 2,717
Liabilities			
Deferred preneed cemetery revenue, net	\$ 45,997	\$ 50,445	\$ (4,448)
Deferred preneed funeral revenue, net	\$ 28,606	\$ 36,912	\$ (8,306)
Deferred tax liability	\$ 31,263	\$ 30,635	\$ 628
Stockholders' equity:			
Retained earnings	\$ 71,680	\$ 69,591	\$ 2,089

The following table presents the impact of the adoption of Topic 606 on our Consolidated Statement of Operations (in thousands, except per share data):

	Year Ended December 31, 2018		
	As Reported	Balances Without Adoption of Topic 606	Effect of Change
Field costs and expenses	\$ 192,045	\$ 191,984	\$ 61
Income before income taxes	\$ 18,266	\$ 18,327	\$ (61)
Net income	\$ 11,645	\$ 11,687	\$ (42)
Basic earnings per common share:	\$ 0.64	\$ 0.64	\$ —
Diluted earnings per common share:	\$ 0.63	\$ 0.63	\$ —
Dividends declared per common share	\$ 0.300	\$ 0.300	\$ —

The following table presents the impact of the adoption of Topic 606 on our Consolidated Statement of Cash Flows (in thousands):

	Year Ended December 31, 2018		
	As Reported	Balances Without Adoption of Topic 606	Effect of Change
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of capitalized commissions on preneed contracts	\$ 723	\$ —	\$ 723
Changes in operating assets and liabilities that provided (required) cash:			
Intangible and other non-current assets	\$ (662)	\$ —	\$ (662)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The cumulative effect of changes made to our opening Consolidated Balance Sheet on January 1, 2018 for the adoption of Topic 606 was as follows (in thousands):

	<u>December 31, 2017</u>	<u>Effect of Adoption of Topic 606</u>	<u>January 1, 2018</u>
Assets			
Accounts receivable, net of allowance for bad debts ⁽¹⁾	\$ 19,655	\$ (1,399)	\$ 18,256
Preneed receivables, net of allowance for bad debts ⁽²⁾⁽³⁾	\$ 31,644	\$ (11,129)	\$ 20,515
Intangible and other non-current assets ⁽⁴⁾	\$ —	\$ 2,778	\$ 2,778
		<u>\$ (9,750)</u>	
Liabilities			
Deferred preneed cemetery revenue ⁽¹⁾⁽²⁾	\$ 54,690	\$ (4,594)	\$ 50,096
Deferred preneed funeral revenue ⁽³⁾	\$ 34,585	\$ (7,934)	\$ 26,651
Deferred tax liability ⁽⁴⁾	\$ 31,159	\$ 647	\$ 31,806
Stockholders' equity:			
Retained earnings ⁽⁴⁾	\$ 57,904	\$ 2,131	\$ 60,035
		<u>\$ (9,750)</u>	

- (1) Under Topic 606, receivables represent an entity's unconditional right to consideration, billed or unbilled. Our balance of accounts receivable, net of allowance for bad debts, of \$19.7 million at December 31, 2017, included the current portion of receivables for preneed cemetery merchandise and service contracts totaling \$1.4 million. As these amounts represent undelivered performance obligations, they have been reclassified to reduce deferred preneed cemetery revenue on January 1, 2018.
- (2) Under Topic 606, receivables represent an entity's unconditional right to consideration, billed or unbilled. Our balance of preneed receivables, net of allowance for bad debts, of \$31.6 million at December 31, 2017, included the non-current portion of receivables for preneed cemetery merchandise and service contracts totaling \$4.6 million. As these amounts represent undelivered performance obligations, they have been reclassified to reduce deferred preneed cemetery revenue on January 1, 2018.
- (3) Under Topic 606, receivables represent an entity's unconditional right to consideration, billed or unbilled. Our balance of preneed receivables, net of allowance for bad debts, \$31.6 million at December 31, 2017, included the non-current portion of receivables for preneed funeral trust contracts totaling \$7.9 million. As these amounts represent undelivered performance obligations, they have been reclassified to reduce deferred preneed funeral revenue on January 1, 2018.
- (4) Under Topic 606, certain costs incurred to obtain or fulfill a contract with a customer are capitalized. Beginning January 1, 2018, we capitalize selling costs related to undelivered preneed cemetery merchandise and services and preneed funeral trust contracts. Previously, these costs were expensed in the period incurred. We recorded a cumulative adjustment of \$2.1 million to our opening Retained earnings, which consisted of a \$2.8 million adjustment to our Intangible and other non-current assets and a \$0.6 million adjustment to our Deferred tax liability on our Consolidated Balance Sheet on January 1, 2018.

The following accounting pronouncements were adopted on January 1, 2018 with no impact to our Consolidated Financial Statements:

Compensation (Topic 718): Stock Compensation – Scope of Modification Accounting

The amendments in this ASU provide guidance about which changes to the terms and conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification unless the fair value, vesting conditions and classification of the modified award are the same as the original award immediately before the award is modified.

Business Combinations (Topic 805): Clarifying the Definition of a Business

This ASU applies to all entities that must determine whether they have acquired or sold a business. The amendments in this ASU clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses.

Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments

This ASU applies to all entities that are required to present a statement of cash flows under Topic 230. The amendments provide guidance on eight specific cash flow issues and includes clarification on how these items should be classified in the statement of cash flows and is designed to help eliminate diversity in practice as to where items are classified in the cash flow statement. In November 2016, the FASB issued additional guidance on this topic that requires amounts generally described as restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the statement of cash flows.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities

The amendments in this ASU address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments and apply to all entities that hold financial assets or owe financial liabilities. The amendments in this ASU also simplify the impairment assessment of equity investments without readily determinable fair values by requiring assessment for impairment qualitatively at each reporting period. That impairment assessment is similar to the qualitative assessment for long-lived assets, goodwill, and indefinite-lived intangible assets.

Accounting Pronouncements Not Yet Adopted

Financial Instruments - Credit Losses

In June 2016, the FASB issued ASU, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This ASU applies to all entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The main objective of the ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. This amendment replaces the incurred loss impairment methodology in the current standard with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, with earlier application permitted for all entities. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2020 and are currently evaluating the impact the adoption of this new accounting standard will have on our Consolidated Financial Statements.

Leases

In February 2016, January 2018, July 2018, and December 2018, the FASB issued and amended ASU's related to *Leases (Topic 842)*. These ASU's supersede the current lease accounting requirements for lessees and lessors within *Topic 840, Leases*. Lessees will be required to recognize all leases, including operating leases, on the balance sheet and record a liability to make lease payments and a corresponding right-of-use (“ROU”) asset representing its right to use the underlying asset for the lease term, recognize a single lease cost, which is allocated over the lease term, generally on a straight line basis, and classify all cash payments within operating activities in the statement of cash flows. Accounting for lessors is substantially unchanged from current accounting principles. Lessees will be required to classify leases as either finance leases or operating leases. Initial balance sheet measurement is similar for both types of leases; however, expense recognition and amortization of ROU assets will differ.

This ASU provides optional practical expedients in transition. We expect to elect the ‘package of practical expedients’ that would allow us to carryforward the historical lease classification. We also expect to elect the use-of-hindsight practical expedient and to include both the lease and non-lease components as a single component. The new standard also provides practical expedients for an entity’s ongoing accounting. We currently expect to elect the short-term lease recognition exemption for all leases that qualify, which means leases with initial terms of 12 months or less will not be recorded on the balance sheet. We are substantially complete with our reassessment, and as a result, certain arrangements will no longer be considered a lease under Topic 842.

This ASU also provides an optional transition practical expedient that allows companies to adopt the ASU with a cumulative effect adjustment as of the beginning of the year of adoption with prior year comparative financial information and disclosures remaining as previously reported. We plan to elect this practical expedient and do not expect a material adjustment to beginning retained earnings. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2019.

While we continue to assess all of the effects of adoption of this ASU, we currently expect the following impact: i) the recognition of new ROU assets and lease liabilities on our balance sheet, which are expected to range from \$15 million to \$17 million; and ii) providing new disclosures regarding key information about leasing arrangements. We do not expect this ASU to have a material impact on our results of operations, cash flows, or liquidity measures, such as debt covenant ratios.

3. ACQUISITIONS

On July 10, 2018, we acquired two funeral home businesses, one in Fredericksburg, Virginia and one in Stafford, Virginia, for \$29.2 million in cash. On August 21, 2018, we acquired a funeral home business in Cookeville, Tennessee for \$2.8 million in cash. On August 28, 2018, we acquired a funeral home business in Knightdale, North Carolina for \$6.0 million in cash.

For the acquisitions, we acquired substantially all the assets and assumed certain operating liabilities. The pro forma impact of these acquisitions on prior periods is not presented, as the impact is not material to our reported results. The results of the acquired businesses are included in our results from the date of acquisition.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following table summarizes the breakdown of the purchase price allocation for the businesses described above (in thousands):

	Purchase Price Allocation
Current assets	\$ 166
Property, plant & equipment	17,543
Goodwill	16,777
Intangible and other non-current assets	3,863
Assumed liabilities	(399)
Purchase price	<u>\$ 37,950</u>

The intangible and other non-current assets relate to the fair value of tradenames and agreements not-to-compete and the assumed liabilities relate to the obligations associated with certain financed automobiles we acquired.

The following table summarizes the fair value of the assets acquired for these businesses (in millions):

Acquisition Date	Type of Business	Market	Assets Acquired (Excluding Goodwill)	Goodwill Recorded	Liabilities and Debt Assumed
July 10, 2018	Two Funeral Homes	Fredericksburg/Stafford, VA	\$ 13.2	\$ 16.0	\$ —
August 21, 2018	One Funeral Home	Cookeville, TN	\$ 2.5	\$ 0.5	\$ (0.2)
August 28, 2018	One Funeral Home	Knightdale, NC	\$ 5.9	\$ 0.3	\$ (0.2)

As of December 31, 2018, our accounting for our 2018 acquisitions is complete. See Note 13 to the Consolidated Financial Statements included herein for additional information on our intangible and other non-current assets.

During 2017, we acquired a funeral home business in Longmont, Colorado for \$2.2 million in cash and we acquired a funeral home business in Loveland, Colorado for \$2.3 million in cash. We also acquired five funeral home businesses on Long Island, New York for \$23.0 million in cash.

The following table summarizes the breakdown of the purchase price allocation for the businesses acquired during 2017 (in thousands):

	Purchase Price Allocation
Current assets	\$ 180
Property, plant & equipment	12,195
Goodwill	12,469
Intangible and other non-current assets	3,309
Assumed liabilities	(63)
Obligations under capital lease	(590)
Purchase price	<u>\$ 27,500</u>

The intangible and other non-current assets relate to the fair value of tradenames and agreements not-to-compete and the assumed liabilities relate to the obligations associated with certain financed automobiles we acquired.

The following table summarizes the fair value of the assets acquired for the businesses acquired during 2017 (in millions):

Acquisition Date	Type of Business	Market	Assets Acquired (Excluding Goodwill)	Goodwill Recorded	Liabilities and Debt Assumed
November 7, 2017	One Funeral Home	Longmont, CO	\$ 1.5	\$ 0.7	\$ —
November 7, 2017	One Funeral Home	Loveland, CO	\$ 1.7	\$ 0.7	\$ (0.1)
December 5, 2017	Five Funeral Homes	Long Island, NY	\$ 12.5	\$ 11.1	\$ (0.6)

4. GOODWILL

Many of the former owners and staff of our acquired funeral homes and certain cemeteries have provided high quality service to families for generations. The resulting loyalty often represents a substantial portion of the value of a business. The excess of the purchase price over the fair value of identifiable net assets of funeral home businesses acquired is recorded as goodwill. Goodwill has primarily been recorded in connection with the acquisition of funeral home businesses.

Our goodwill has an indefinite life and is not subject to amortization. As such, we test goodwill for impairment on an annual basis. Under current guidance, we are permitted to first assess qualitative factors to determine whether it is more-likely-than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a quantitative goodwill impairment test. Our intent is to perform the quantitative impairment test at least once every three years unless certain indicators or events suggest otherwise and perform the qualitative assessment during the remaining two years. For our 2018 annual impairment test, we performed a qualitative assessment. We determined that there were no factors that would indicate the need to perform a quantitative goodwill impairment test and concluded that it is more-likely-than not that the fair value of our reporting units is greater than their carrying value and thus there was no impairment to goodwill.

See Note 1 to the Consolidated Financial Statements included herein, for a discussion of the methodology used for our annual goodwill impairment test.

The following table presents changes in goodwill in the accompanying Consolidated Balance Sheet for the years ended December 31, 2017 and 2018 (in thousands):

	<u>December 31, 2017</u>	<u>December 31, 2018</u>
Goodwill at the beginning of year	\$ 275,487	\$ 287,956
Increase in goodwill related to acquisitions	12,469	16,777
Decrease in goodwill related to impairments	—	(846)
Goodwill at the end of the year	<u>\$ 287,956</u>	<u>\$ 303,887</u>

5. DIVESTED OPERATIONS

During 2018, our management agreement with a Florida municipality expired and as a result, we ceased to operate three of our cemetery businesses. During 2017, we sold a funeral home business in Kentucky for \$0.6 million. During 2016, we sold a funeral home business in Tennessee for \$1.35 million. We continually review locations to optimize the sustainable earning power and return on our invested capital. These reviews could entail selling certain non-strategic businesses.

The operating results of these divested businesses are reflected in our Consolidated Statements of Operations as shown in the table below (in thousands):

	<u>Year Ended December 31,</u>		
	<u>2016</u>	<u>2017</u>	<u>2018</u>
Revenue	\$ 744	\$ 605	\$ 4,712
Operating income	314	277	1,130
Other, net ⁽¹⁾	(29)	191	(349)
Income tax provision	(112)	(187)	(246)
Net income from divested operations	<u>\$ 173</u>	<u>\$ 281</u>	<u>\$ 535</u>

(1) Reflects the net gain (loss) on disposal.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

6. REVENUE FROM CONTRACTS WITH CUSTOMERS

Revenue

Our operations are reported in two business segments: Funeral Home Operations and Cemetery Operations. Revenue, disaggregated by major source for each of our reportable segments was as follows (in thousands):

For The Year Ended, December 31, 2018

	<u>Funeral</u>	<u>Cemetery</u>	<u>Total</u>
Services	\$ 127,262	\$ 11,342	\$ 138,604
Merchandise	74,644	8,158	82,802
Cemetery property	—	29,451	29,451
Other revenue	8,819	8,316	17,135
Total	<u>\$ 210,725</u>	<u>\$ 57,267</u>	<u>\$ 267,992</u>

For The Year Ended, December 31, 2017

	<u>Funeral</u>	<u>Cemetery</u>	<u>Total</u>
Services	\$ 120,827	\$ 11,765	\$ 132,592
Merchandise	71,573	8,187	79,760
Cemetery property	—	28,286	28,286
Other revenue	8,486	9,015	17,501
Total	<u>\$ 200,886</u>	<u>\$ 57,253</u>	<u>\$ 258,139</u>

For The Year Ended, December 31, 2016

	<u>Funeral</u>	<u>Cemetery</u>	<u>Total</u>
Services	\$ 113,131	\$ 11,230	\$ 124,361
Merchandise	67,493	7,982	75,475
Cemetery property	—	29,735	29,735
Other revenue	8,777	9,852	18,629
Total	<u>\$ 189,401</u>	<u>\$ 58,799</u>	<u>\$ 248,200</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Deferred Revenue

Deferred revenue is presented net of amounts due on undelivered preneed contracts shown below as of January 1, 2018 and December 31, 2018 (in thousands):

	<u>January 1, 2018⁽¹⁾</u>	<u>December 31, 2018</u>
Contract liabilities:		
Deferred preneed cemetery revenue	\$ 54,690	\$ 50,445
Less: Balances due on undelivered cemetery preneed contracts ⁽²⁾	(4,594)	(4,448)
Deferred preneed cemetery revenue, net	<u>\$ 50,096</u>	<u>\$ 45,997</u>
Deferred preneed funeral revenue	\$ 34,585	\$ 36,912
Less: Balances due on undelivered funeral preneed contracts ⁽³⁾	(7,934)	(8,306)
Deferred preneed funeral revenue, net	<u>\$ 26,651</u>	<u>\$ 28,606</u>

(1) January 1, 2018 balances have been adjusted to reflect the cumulative effect of changes for the adoption of ASC 606.

(2) In accordance with Topic 606, \$1.4 million of cemetery accounts receivables have been reclassified to reduce deferred preneed cemetery revenue at both January 1, 2018 and December 31, 2018 and \$3.2 million and \$3.1 million of preneed cemetery receivables have been reclassified to reduce deferred preneed cemetery revenue at January 1, 2018 and December 31, 2018, respectively.

(3) In accordance with Topic 606, \$7.9 million and \$8.3 million of preneed funeral receivables have been reclassified to reduce deferred preneed funeral revenue at January 1, 2018 and December 31, 2018, respectively.

Our merchandise and service performance obligations related to our preneed contracts are considered fulfilled at the point in time the merchandise is delivered or the burial, cremation or interment service is performed. The transaction price allocated to preneed merchandise and service performance obligations that were unfulfilled at December 31, 2018 was \$4.4 million for preneed cemetery contracts and \$8.3 million for preneed funeral contracts. As these performance obligations are to be completed after the date of death, we cannot quantify the recognition of revenue for any given period. However, we estimate an average maturity period of eight years for preneed cemetery contracts and ten years for preneed funeral contracts.

7. PRENEED TRUST INVESTMENTS

Preneed Cemetery Trust Investments

Preneed cemetery trust investments represent trust fund assets that we are generally permitted to withdraw as the services and merchandise are provided to customers. Preneed cemetery contracts are secured by payments from customers, less amounts not required by law to be deposited into trust. Preneed cemetery trust investments are reduced by the trust earnings we have been allowed to withdraw in certain states prior to our performance.

The components of *Preneed cemetery trust investments* on our Consolidated Balance Sheet at December 31, 2017 and 2018 were as follows (in thousands):

	<u>December 31, 2017</u>	<u>December 31, 2018</u>
Preneed cemetery trust investments, at market value	\$ 75,992	\$ 64,549
Less: allowance for contract cancellation	(2,139)	(2,117)
Preneed cemetery trust investments, net	<u>\$ 73,853</u>	<u>\$ 62,432</u>

Upon cancellation of a preneed cemetery contract, a customer is generally entitled to receive a refund of the corpus, and in some instances, a portion of all of the earnings held in trust. In certain jurisdictions, we may be obligated to fund any shortfall if the amounts deposited by the customer exceed the funds in trust, including investment income. As a result, when realized or unrealized losses of a trust result in the trust being underfunded, we assess whether we are responsible for replenishing the corpus of the trust, in which case a loss provision is recorded. At December 31, 2018, none of our preneed cemetery trust investments were underfunded.

Earnings from our preneed cemetery trust investments are recognized in revenue when a service is performed or merchandise is delivered. Trust management fees charged by CSV RIA are included as revenue in the period in which they are earned.

Where quoted prices are available in an active market, investments held by the trusts are classified as Level 1 investments pursuant to the three-level valuation hierarchy. Our Level 1 investments include cash and common stock. Where quoted market

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

prices are not available for the specific security, fair values are estimated by using quoted prices of similar securities in active markets or other inputs other than quoted prices that can corroborate observable market data. These investments are fixed income securities, including municipal bonds, foreign debt, corporate debt, preferred stock, mortgage-backed securities and fixed income mutual funds, all of which are classified within Level 2 of the valuation hierarchy. We review and update our fair value hierarchy classifications quarterly. There were no transfers between Levels 1 and 2 in the year ended December 31, 2018. There are no Level 3 investments in the preneed cemetery trust investment portfolio. See Note 12 to the Consolidated Financial Statements included herein for further information of the fair value measurement and the three-level valuation hierarchy.

The cost and fair market values associated with preneed cemetery trust investments at December 31, 2018 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$ 16,194	\$ —	\$ —	\$ 16,194
Fixed income securities:					
Foreign debt	2	3,802	43	(511)	3,334
Corporate debt	2	13,987	362	(1,026)	13,323
Preferred stock	2	11,068	54	(1,146)	9,976
Mortgage-backed securities	2	666	161	(14)	813
Common stock	1	24,867	903	(5,436)	20,334
Trust securities		<u>\$ 70,584</u>	<u>\$ 1,523</u>	<u>\$ (8,133)</u>	<u>\$ 63,974</u>
Accrued investment income		<u>\$ 575</u>			<u>\$ 575</u>
Preneed cemetery trust investments					<u>\$ 64,549</u>
Market value as a percentage of cost					<u>90.6%</u>

The estimated maturities of the fixed income securities included above are as follows (in thousands):

Due in one year or less	\$ —
Due in one to five years	2,116
Due in five to ten years	3,847
Thereafter	21,483
Total fixed income securities	<u>\$ 27,446</u>

The cost and market values associated with preneed cemetery trust investments at December 31, 2017 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$ 3,132	\$ —	\$ —	\$ 3,132
Fixed income securities:					
Municipal bonds	2	—	—	—	—
Foreign debt	2	4,834	292	(193)	4,933
Corporate debt	2	18,238	1,184	(273)	19,149
Preferred stock	2	16,421	510	(588)	16,343
Mortgage-backed securities	2	1,018	249	(24)	1,243
Common stock	1	26,465	5,250	(2,460)	29,255
Mutual funds:					
Fixed Income	2	1,198	50	(11)	1,237
Trust Securities		<u>\$ 71,306</u>	<u>\$ 7,535</u>	<u>\$ (3,549)</u>	<u>\$ 75,292</u>
Accrued investment income		<u>\$ 700</u>			<u>\$ 700</u>
Preneed cemetery trust investments					<u>\$ 75,992</u>
Market value as a percentage of cost					<u>105.6%</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The estimated maturities of the fixed income securities included above are as follows (in thousands):

Due in one year or less	\$ 303
Due in one to five years	2,183
Due in five to ten years	5,376
Thereafter	33,806
Total fixed income securities	<u>\$ 41,668</u>

We determine whether or not the assets in the preneed cemetery trust investments have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria, including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis of the investment due to an other-than-temporary impairment is likewise recorded as a reduction in *Deferred preneed cemetery receipts held in trust* on our Consolidated Balance Sheet. We did not record any impairments in the year ended December 31, 2017 and 2018. There is no impact on earnings until such time that the loss is realized in the trusts, allocated to the preneed contracts and the services are performed or the merchandise is delivered causing the contract to be withdrawn from the trust in accordance with state regulations.

At December 31, 2018, we had certain investments within our preneed cemetery trust investments that had tax lots in loss positions for more than one year. Based on our analyses of these securities, the companies' businesses and current market conditions, we determined that these investment losses were temporary in nature.

Our preneed cemetery trust investment unrealized losses, their associated fair market values, and the duration of unrealized losses as of December 31, 2018 are shown in the following tables (in thousands):

	December 31, 2018					
	In Loss Position Less than 12 months		In Loss Position Greater than 12 months		Total	
	Fair market value	Unrealized Losses	Fair market value	Unrealized Losses	Fair market value	Unrealized Losses
Fixed income securities:						
Foreign debt	\$ 2,140	\$ (245)	\$ 895	\$ (266)	\$ 3,035	\$ (511)
Corporate debt	9,918	(813)	443	(213)	10,361	(1,026)
Preferred stock	5,253	(399)	3,767	(747)	9,020	(1,146)
Mortgage-backed securities	—	—	51	(14)	51	(14)
Common stock	14,191	(4,012)	1,190	(1,424)	15,381	(5,436)
Total temporary impaired securities	<u>\$ 31,502</u>	<u>\$ (5,469)</u>	<u>\$ 6,346</u>	<u>\$ (2,664)</u>	<u>\$ 37,848</u>	<u>\$ (8,133)</u>

Our preneed cemetery trust investment unrealized losses, their associated fair market values, and the duration of unrealized losses as of December 31, 2017 are shown in the following tables (in thousands):

	December 31, 2017					
	In Loss Position Less than 12 months		In Loss Position Greater than 12 months		Total	
	Fair market value	Unrealized Losses	Fair market value	Unrealized Losses	Fair market value	Unrealized Losses
Fixed income securities:						
Foreign debt	\$ 151	\$ (6)	\$ 1,637	\$ (187)	\$ 1,788	\$ (193)
Corporate debt	3,735	(72)	846	(201)	4,581	(273)
Preferred stock	48	—	8,109	(588)	8,157	(588)
Mortgage-backed securities	127	(15)	27	(9)	154	(24)
Common stock	8,249	(1,512)	1,742	(948)	9,991	(2,460)
Mutual funds:						
Fixed Income	496	(11)	—	—	496	(11)
Total temporary impaired securities	<u>\$ 12,806</u>	<u>\$ (1,616)</u>	<u>\$ 12,361</u>	<u>\$ (1,933)</u>	<u>\$ 25,167</u>	<u>\$ (3,549)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Preneed cemetery trust investment security transactions recorded in *Other, net* on our Consolidated Statements of Operations for the years ended December 31, 2016, 2017 and 2018 were as follows (in thousands):

	Year ended December 31,		
	2016	2017	2018
Investment income	\$ 2,250	\$ 2,250	\$ 1,596
Realized gains	2,141	2,218	4,546
Realized losses	(6,559)	(2,384)	(5,817)
Expenses and taxes	(1,266)	(1,308)	(907)
Net change in deferred preneed cemetery receipts held in trust	3,434	(776)	582
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Purchases and sales of investments in the preneed cemetery trusts for the years ended December 31, 2016, 2017 and 2018 were as follows (in thousands):

	Year ended December 31,		
	2016	2017	2018
Purchases	\$ (25,643)	\$ (21,966)	\$ (27,006)
Sales	25,846	14,002	39,180

Preneed Funeral Trust Investments

Preneed funeral trust investments represent trust fund assets that we are permitted to withdraw as services and merchandise are provided to customers. Preneed funeral contracts are secured by payments from customers, less retained amounts not required to be deposited into trust. Preneed funeral trust investments are reduced by the trust earnings we have been allowed to withdraw in certain states prior to our performance.

The components of *Preneed funeral trust investments* on our Consolidated Balance Sheet at December 31, 2017 and 2018 were as follows (in thousands):

	December 31, 2017	December 31, 2018
Preneed funeral trust investments, at market value	\$ 93,341	\$ 84,803
Less: allowance for contract cancellation	(2,659)	(2,729)
Preneed funeral trust investments, net	<u>\$ 90,682</u>	<u>\$ 82,074</u>

Upon cancellation of a preneed funeral contract, a customer is generally entitled to receive a refund of the corpus and in some instances, a portion of all earnings held in trust. In certain jurisdictions, we may be obligated to fund any shortfall if the amounts deposited by the customer exceed the funds in trust, including investment income. As a result, when realized or unrealized losses of a trust result in the trust being underfunded, we assess whether we are responsible for replenishing the corpus of the trust, in which case a loss provision is recorded. At December 31, 2018, none of our preneed funeral trust investments were underfunded.

Earnings from our preneed funeral trust investments are recognized in revenue when a service is performed or merchandise is delivered. Trust management fees charged by CSV RIA are included in revenue in the period in which they are earned.

Where quoted prices are available in an active market, investments held by the trusts are classified as Level 1 investments pursuant to the three-level valuation hierarchy. Our Level 1 investments include cash, U.S. treasury debt and common stock. Where quoted market prices are not available for the specific security, then fair values are estimated by using quoted prices of similar securities in active markets or other inputs other than quoted prices that can corroborate observable market data. These investments are fixed income securities, including municipal bonds, foreign debt, corporate debt, preferred stocks, mortgage-backed securities and fixed income mutual funds and other investments, all of which are classified within Level 2 of the valuation hierarchy. We review and update our fair value hierarchy classifications quarterly. There were no transfers between Levels 1 and 2 for the year ended December 31, 2018. There are no Level 3 investments in the preneed funeral trust investment portfolio. See Note 12 to the Consolidated Financial Statements included herein for further information of the fair value measurement and the three-level valuation hierarchy.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The cost and fair market values associated with preneed funeral trust investments at December 31, 2018 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$ 31,375	\$ —	\$ —	\$ 31,375
Fixed income securities:					
U.S. treasury debt	1	1,319	3	(19)	1,303
Foreign debt	2	3,748	44	(503)	3,289
Corporate debt	2	14,195	294	(1,025)	13,464
Preferred stock	2	11,500	54	(1,194)	10,360
Mortgage-backed securities	2	772	168	(18)	922
Common stock	1	24,803	887	(5,389)	20,301
Mutual funds:					
Fixed income	2	275	—	(29)	246
Other investments	2	3,006	—	—	3,006
Trust securities		<u>\$ 90,993</u>	<u>\$ 1,450</u>	<u>\$ (8,177)</u>	<u>\$ 84,266</u>
Accrued investment income		<u>\$ 537</u>			<u>\$ 537</u>
Preneed funeral trust investments					<u>\$ 84,803</u>
Market value as a percentage of cost					<u>92.6%</u>

The estimated maturities of the fixed income securities included above are as follows (in thousands):

Due in one year or less	\$ 495
Due in one to five years	3,054
Due in five to ten years	3,816
Thereafter	21,973
Total fixed income securities	<u>\$ 29,338</u>

The cost and market values associated with preneed funeral trust investments at December 31, 2017 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$ 14,349	\$ —	\$ —	\$ 14,349
Fixed income securities:					
U.S. treasury debt	1	1,490	10	(15)	1,485
Municipal bonds	2	—	—	—	—
Foreign debt	2	4,870	298	(189)	4,979
Corporate debt	2	18,963	1,197	(278)	19,882
Preferred stock	2	16,335	501	(585)	16,251
Mortgage-backed securities	2	1,187	263	(27)	1,423
Common stock	1	26,129	5,253	(2,468)	28,914
Mutual funds:					
Fixed income	2	1,974	52	(48)	1,978
Other investments	2	3,341	—	—	3,341
Trust securities		<u>\$ 88,638</u>	<u>\$ 7,574</u>	<u>\$ (3,610)</u>	<u>\$ 92,602</u>
Accrued investment income		<u>\$ 739</u>			<u>\$ 739</u>
Preneed funeral trust investments					<u>\$ 93,341</u>
Market value as a percentage of cost					<u>104.5%</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The estimated maturities of the fixed income securities included above are as follows (in thousands):

Due in one year or less	\$ 320
Due in one to five years	3,744
Due in five to ten years	5,782
Thereafter	34,174
Total fixed income securities	<u>\$ 44,020</u>

We determine whether or not the assets in the preneed funeral trust investments have other-than-temporary impairments on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis of the investment due to an other-than-temporary impairment is likewise recorded as a reduction to *Deferred preneed funeral receipts held in trust* on our Consolidated Balance Sheet. We did not record any impairments in the year ended December 31, 2017 and 2018. There is no impact on earnings until such time that the loss is realized in the trusts, allocated to preneed contracts and the services are performed or the merchandise is delivered causing the contract to be withdrawn from the trust in accordance with state regulations.

At December 31, 2018, we had certain investments within our preneed funeral trust investments that had tax lots in loss positions for more than one year. Based on our analyses of these securities, the companies' businesses and current market conditions, we determined that these investment losses were temporary in nature.

Our preneed funeral trust investment unrealized losses, their associated fair market values, and the duration of unrealized losses as of December 31, 2018 are shown the the following tables (in thousands):

	December 31, 2018					
	In Loss Position Less than 12 months		In Loss Position Greater than 12 months		Total	
	<u>Fair market value</u>	<u>Unrealized Losses</u>	<u>Fair market value</u>	<u>Unrealized Losses</u>	<u>Fair market value</u>	<u>Unrealized Losses</u>
Fixed income securities:						
U.S. treasury debt	\$ —	\$ —	\$ 1,181	\$ (19)	\$ 1,181	\$ (19)
Foreign debt	2,180	(251)	850	(252)	3,030	(503)
Corporate debt	9,990	(814)	434	(211)	10,424	(1,025)
Preferred stock	5,967	(460)	3,673	(734)	9,640	(1,194)
Mortgage-backed securities	11	—	120	(18)	131	(18)
Common Stock	14,327	(4,035)	1,155	(1,354)	15,482	(5,389)
Mutual funds:						
Fixed income	—	—	246	(29)	246	(29)
Total temporary impaired securities	<u>\$ 32,475</u>	<u>\$ (5,560)</u>	<u>\$ 7,659</u>	<u>\$ (2,617)</u>	<u>\$ 40,134</u>	<u>\$ (8,177)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Our preneed funeral trust investment unrealized losses, their associated fair market values, and the duration of unrealized losses as of December 31, 2017 are shown the the following tables (in thousands):

	December 31, 2017					
	In Loss Position Less than 12 months		In Loss Position Greater than 12 months		Total	
	Fair market value	Unrealized Losses	Fair market value	Unrealized Losses	Fair market value	Unrealized Losses
Fixed income securities:						
U.S. treasury debt	\$ 1,325	\$ (15)	\$ —	\$ —	\$ 1,325	\$ (15)
Foreign debt	159	(6)	1,608	(183)	1,767	(189)
Corporate debt	3,770	(74)	842	(203)	4,612	(277)
Preferred stock	50	—	8,184	(585)	8,234	(585)
Mortgage-backed securities	221	(17)	36	(10)	257	(27)
Common Stock	8,001	(1,496)	1,728	(972)	9,729	(2,468)
Mutual funds:						
Fixed income	549	(12)	615	(37)	1,164	(49)
Total temporary impaired securities	<u>\$ 14,075</u>	<u>\$ (1,620)</u>	<u>\$ 13,013</u>	<u>\$ (1,990)</u>	<u>\$ 27,088</u>	<u>\$ (3,610)</u>

Preneed funeral trust investment security transactions recorded in *Other, net* on our Consolidated Statements of Operations for the years ended December 31, 2016, 2017 and 2018 were as follows (in thousands):

	Year ended December 31,		
	2016	2017	2018
Investment income	\$ 2,344	\$ 2,420	\$ 1,623
Realized gains	2,287	2,386	6,662
Realized losses	(6,642)	(2,396)	(5,882)
Expenses and taxes	(1,174)	(1,290)	(885)
Net change in deferred preneed funeral receipts held in trust	3,185	(1,120)	(1,518)
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Purchases and sales of investments in the preneed funeral trusts for the years ended December 31, 2016, 2017 and 2018 were as follows (in thousands):

	Year ended December 31,		
	2016	2017	2018
Purchases	\$ (26,457)	\$ (21,954)	\$ (28,264)
Sales	27,425	14,463	39,955

8. PRENEED CEMETERY RECEIVABLES

Preneed sales of cemetery interment rights and related products and services are usually financed through interest-bearing installment sales contracts, generally with terms of up to five years with such interest income reflected as *Other revenue*. In substantially all cases, we receive an initial down payment at the time the contract is signed.

Our cemetery financed receivables were comprised of the following at December 31, 2017 and December 31, 2018 (in thousands):

	December 31, 2017	December 31, 2018
Cemetery interment rights	\$ 29,625	\$ 27,728
Cemetery merchandise and services	10,849	9,516
Preneed cemetery receivables	<u>\$ 40,474</u>	<u>\$ 37,244</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Our cemetery financed receivables presented on our Consolidated Balance Sheet at December 31, 2017 and December 31, 2018 are as follows (in thousands):

	<u>December 31, 2017</u>	<u>December 31, 2018</u>
Accounts receivable, including unearned finance charges and allowance for contract cancellations of \$2,779 and \$2,405, respectively	\$ 11,843	\$ 11,676 ⁽¹⁾
Preneed receivables, including unearned finance charges and allowance for contract cancellations of \$4,922 and \$4,049, respectively	28,631	25,568 ⁽²⁾
Preneed cemetery receivables	<u>\$ 40,474</u>	<u>\$ 37,244</u>

⁽¹⁾ In accordance with Topic 606, \$1.4 million of cemetery accounts receivable has been reclassified to reduce deferred preneed cemetery revenue at December 31, 2018.

⁽²⁾ In accordance with Topic 606, \$3.1 million of preneed cemetery receivables has been reclassified to reduce deferred preneed cemetery revenue at December 31, 2018.

The unearned finance charges associated with these receivables were \$5.7 million and \$4.6 million at December 31, 2017 and 2018, respectively.

We determine an allowance for customer cancellations and refunds on contracts in which revenue has been recognized on sales of cemetery interment rights. We have a collections policy where past due notifications are sent to the customer beginning at 15 days past due and periodically thereafter until the contract is cancelled or payment is received. We reserve 100% of the receivables on contracts in which the revenue has been recognized and payments are 90 days past due or more, which was approximately 4.6% of the total receivables on recognized sales at December 31, 2018. An allowance is recorded at the date that the contract is executed and periodically adjusted thereafter based upon actual collection experience at the business level.

For the years ending December 31, 2017 and 2018, the change in the allowance for contract cancellations was as follows (in thousands):

	<u>As of December 31,</u>	
	<u>2017</u>	<u>2018</u>
Beginning balance	\$ 1,861	\$ 2,019
Write-offs and cancellations	(1,298)	(1,357)
Provision	1,456	1,146
Ending balance	<u>\$ 2,019</u>	<u>\$ 1,808</u>

The aging of past due financing receivables as of December 31, 2018 was as follows (in thousands):

	31-60 Past Due	61-90 Past Due	91-120 Past Due	>120 Past Due	Total Past Due	Current	Total Financing Receivables
Recognized revenue	\$ 642	\$ 395	\$ 143	\$ 1,139	\$ 2,319	\$ 25,289	\$ 27,608
Deferred revenue	274	165	53	289	781	8,855	9,636
Total contracts	<u>\$ 916</u>	<u>\$ 560</u>	<u>\$ 196</u>	<u>\$ 1,428</u>	<u>\$ 3,100</u>	<u>\$ 34,144</u>	<u>\$ 37,244</u>

The aging of past due financing receivables as of December 31, 2017 was as follows (in thousands):

	31-60 Past Due	61-90 Past Due	91-120 Past Due	>120 Past Due	Total Past Due	Current	Total Financing Receivables
Recognized revenue	\$ 1,140	\$ 530	\$ 155	\$ 1,301	\$ 3,126	\$ 26,449	\$ 29,575
Deferred revenue	380	171	63	392	1,006	9,893	10,899
Total contracts	<u>\$ 1,520</u>	<u>\$ 701</u>	<u>\$ 218</u>	<u>\$ 1,693</u>	<u>\$ 4,132</u>	<u>\$ 36,342</u>	<u>\$ 40,474</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. RECEIVABLES FROM PRENEED TRUSTS

The receivables from preneed trusts represent assets in trusts which are controlled and operated by third parties in which we do not have a controlling financial interest (less than 50%) in the trust assets. We account for these investments at cost. As of December 31, 2017 and 2018, receivables from preneed trusts were as follows (in thousands):

	December 31, 2017	December 31, 2018
Preneed trust funds, at cost	\$ 15,759	\$ 17,601
Less: allowance for contract cancellation	(472)	(528)
Receivables from preneed trusts, net	<u>\$ 15,287</u>	<u>\$ 17,073</u>

The following summary reflects the composition of the assets held in trust and controlled by third parties to satisfy our future obligations under preneed arrangements related to the preceding contracts at December 31, 2017 and 2018. The cost basis includes reinvested interest and dividends that have been earned on the trust assets. Fair value includes unrealized gains and losses on trust assets.

The composition of the preneed trust funds at December 31, 2018 was as follows (in thousands):

	Historical Cost Basis	Fair Value
As of December 31, 2018		
Cash and cash equivalents	\$ 4,172	\$ 4,172
Fixed income investments	10,668	10,668
Mutual funds and common stocks	2,755	2,709
Annuities	6	6
Total	<u>\$ 17,601</u>	<u>\$ 17,555</u>

The composition of the preneed trust funds at December 31, 2017 was as follows (in thousands):

	Historical Cost Basis	Fair Value
As of December 31, 2017		
Cash and cash equivalents	\$ 3,903	\$ 3,903
Fixed income investments	9,306	9,306
Mutual funds and common stocks	2,544	2,567
Annuities	6	6
Total	<u>\$ 15,759</u>	<u>\$ 15,782</u>

10. CONTRACTS FUNDED BY INSURANCE

When preneed funeral contracts are funded through third-party insurance policies, we earn a commission on the sale of the policies. Insurance commissions are subject to refund (charge-back) if the preneed policy is cancelled within a year or if there is an imminent death of beneficiary before the first year anniversary of the policy. We record these insurance commissions as *Other revenue*, as noted in our table of disaggregated revenue in Note 6 to the Consolidated Financial Statements included herein, when the commission is no longer subject to refund, which is typically one year after the policy is issued. All selling costs incurred pursuant to the sale of the insurance funded preneed contracts are expensed as incurred. Preneed funeral contracts to be funded at maturity by third-party insurance policies totaled \$371.5 million and \$388.2 million at December 31, 2017 and 2018, respectively, and are not recorded as assets or liabilities on our Consolidated Balance Sheet.

Generally, at the time of the sale of either the preneed insurance or preneed trust contract, the intent is that the beneficiary has made a commitment to assign the proceeds to us for the fulfillment of the service and merchandise obligations on the preneed contract at the time of need. However, this commitment is revocable and the proceeds from the policy are portable, so the customer can choose to use an alternative provider at the time of need.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

11. CEMETERY PERPETUAL CARE TRUST INVESTMENTS

Care trusts' corpus on our Consolidated Balance Sheet represent the corpus of those trusts plus undistributed income. The components of *Care trusts' corpus* as of December 31, 2017 and 2018 were as follows (in thousands):

	<u>December 31, 2017</u>	<u>December 31, 2018</u>
Trust assets, at market value	\$ 50,229	\$ 44,071
Obligations due from trust	(373)	(577)
Care trusts' corpus	<u>\$ 49,856</u>	<u>\$ 43,494</u>

We are required by various state laws to pay a portion of the proceeds from the sale of cemetery property interment rights into perpetual care trust funds. The income earned from these perpetual care trusts offsets maintenance expenses for cemetery property and memorials. This trust fund income is recognized, as earned, in *Other revenue*. Trust management fees charged by CSV RIA are included in revenue in the period in which they are earned. At December 31, 2018, none of our cemetery perpetual care trust investments were underfunded.

Where quoted prices are available in an active market, investments held by the trusts are classified as Level 1 investments pursuant to the three-level valuation hierarchy. Our Level 1 investments include cash and common stock. Where quoted market prices are not available for the specific security, then fair values are estimated by using quoted prices of similar securities in active markets or other inputs other than quoted prices that can corroborate observable market data. These investments are fixed income securities, including municipal bonds, foreign debt, corporate debt, preferred stock, mortgage-backed securities and fixed income mutual funds, all of which are classified within Level 2 of the valuation hierarchy. There were no transfers between Levels 1 and 2 for the year ended December 31, 2018. There are no Level 3 investments in the cemetery perpetual care trust investment portfolio. See Note 12 to the Consolidated Financial Statements included herein for further information of the fair value measurement and the three-level valuation hierarchy.

The following table reflects the cost and fair market values associated with the trust investments held in perpetual care trust funds at December 31, 2018 (in thousands):

	<u>Fair Value Hierarchy Level</u>	<u>Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Market Value</u>
Cash and money market accounts	1	\$ 11,144	\$ —	\$ —	\$ 11,144
Fixed income securities:					
Foreign debt	2	2,872	27	(385)	2,514
Corporate debt	2	9,956	227	(730)	9,453
Preferred stock	2	8,141	37	(820)	7,358
Mortgage-backed securities	2	417	101	(9)	509
Common stock	1	15,562	542	(3,395)	12,709
Trust securities		<u>\$ 48,092</u>	<u>\$ 934</u>	<u>\$ (5,339)</u>	<u>\$ 43,687</u>
Accrued investment income		<u>\$ 384</u>			<u>\$ 384</u>
Cemetery perpetual care investments					<u>\$ 44,071</u>
Market value as a percentage of cost					<u>90.8%</u>

The estimated maturities of the fixed income securities included above are as follows (in thousands):

Due in one year or less	\$ —
Due in one to five years	1,635
Due in five to ten years	2,879
Thereafter	15,320
Total fixed income securities	<u>\$ 19,834</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following table reflects the cost and market values associated with the trust investments held in perpetual care trust funds at December 31, 2017 (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$ 1,906	\$ —	\$ —	\$ 1,906
Fixed income securities:					
Foreign debt	2	3,580	227	(134)	3,673
Corporate debt	2	12,557	805	(187)	13,175
Preferred stock	2	11,545	364	(411)	11,498
Mortgage-backed securities	2	621	152	(15)	758
Common stock	1	16,326	3,116	(1,595)	17,847
Mutual funds:					
Fixed income	2	913	42	(10)	945
Trust securities		\$ 47,448	\$ 4,706	\$ (2,352)	\$ 49,802
Accrued investment income		\$ 427			\$ 427
Cemetery perpetual care investments					\$ 50,229
Market value as a percentage of cost					105.0%

We determine whether or not the assets in the cemetery perpetual care trusts have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis due to an other-than-temporary impairment is also recorded as a reduction to *Care trusts' corpus*. We did not record any impairments in the year ended December 31, 2017 and 2018.

At December 31, 2018, we had certain investments within our perpetual care trust investments that had tax lots in loss positions for more than one year. Based on our analyses of these securities, the companies' businesses and current market conditions, we determined that these investments losses were temporary in nature.

Our perpetual care trust investment unrealized losses, their associated fair market values, and the duration of unrealized losses for the year ended December 31, 2018 are shown in the following tables (in thousands):

	December 31, 2018					
	In Loss Position Less than 12 months		In Loss Position Greater than 12 months		Total	
	Fair market value	Unrealized Losses	Fair market value	Unrealized Losses	Fair market value	Unrealized Losses
Fixed income securities:						
Foreign debt	\$ 1,619	\$ (189)	\$ 639	\$ (196)	\$ 2,258	\$ (385)
Corporate debt	7,006	(587)	301	(143)	7,307	(730)
Preferred stock	3,586	(279)	2,787	(541)	6,373	(820)
Mortgage-backed securities	—	—	32	(9)	32	(9)
Common stock	9,010	(2,557)	733	(838)	9,743	(3,395)
Total temporary impaired securities	\$ 21,221	\$ (3,612)	\$ 4,492	\$ (1,727)	\$ 25,713	\$ (5,339)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Our perpetual care trust investment unrealized losses, their associated fair market values, and the duration of unrealized losses for the year ended December 31, 2017 are shown in the following tables (in thousands):

	December 31, 2017					
	In Loss Position Less than 12 months		In Loss Position Greater than 12 months		Total	
	Fair market value	Unrealized Losses	Fair market value	Unrealized Losses	Fair market value	Unrealized Losses
Fixed income securities:						
Foreign debt	92	(3)	1,128	(131)	1,220	(134)
Corporate debt	2,621	(59)	555	(128)	3,176	(187)
Preferred stock	29	—	5,492	(411)	5,521	(411)
Mortgage-backed securities	76	(10)	16	(5)	92	(15)
Common stock	5,119	(991)	1,108	(604)	6,227	(1,595)
Mutual funds:						
Fixed income	433	(10)	—	—	433	(10)
Total temporary impaired securities	<u>\$ 8,370</u>	<u>\$ (1,073)</u>	<u>\$ 8,299</u>	<u>\$ (1,279)</u>	<u>\$ 16,669</u>	<u>\$ (2,352)</u>

Perpetual care trust investment security transactions recorded in *Other, net* on our Consolidated Statements of Operations for the years ended December 31, 2016, 2017 and 2018 were as follows (in thousands):

	Year ended December 31,		
	2016	2017	2018
Realized gains	\$ 872	\$ 926	\$ 1,364
Realized losses	(3,069)	(1,195)	(1,896)
Net change in Care trusts' corpus	2,197	269	532
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Perpetual care trust investment security transactions recorded in *Other revenue* for the years ended December 31, 2016, 2017 and 2018 were as follows (in thousands):

	Year ended December 31,		
	2016	2017	2018
Investment income	\$ 6,451	\$ 5,949	\$ 5,934
Realized gains (losses), net	(434)	(838)	(1,355)
Total	<u>\$ 6,017</u>	<u>\$ 5,111</u>	<u>\$ 4,579</u>

Purchases and sales of investments in the perpetual care trusts for the years ended December 31, 2016, 2017 and 2018 were as follows (in thousands):

	Year ended December 31,		
	2016	2017	2018
Purchases	\$ (16,546)	\$ (13,923)	\$ (17,313)
Sales	16,534	8,899	25,786

12. FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date applicable for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. We disclose the extent to which fair value is used to measure financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date.

We evaluated our financial assets and liabilities for those financial assets and liabilities that met the criteria of the disclosure requirements and fair value framework. The carrying values of cash and cash equivalents, trade receivables, and trade payables approximate the fair values of those instruments due to the short-term nature of the instruments. The fair values of receivables on preneed funeral and cemetery contracts are impracticable to estimate because of the lack of a trading market and the diverse number

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

of individual contracts with varying terms. Our long-term debt and Credit Facility (as defined in Note 14) are classified within Level 2 of the Fair Value Measurements hierarchy. The fair values of the long-term debt and Credit Facility approximate the carrying values of these instruments based on the index yields of similar securities compared to U.S. Treasury yield curves. The fair value of the Convertible Notes (as defined in Note 14) was approximately \$6.2 million at December 31, 2018 based on the last traded or broker quoted price. The fair value of the Senior Notes (as defined in Note 14) was approximately \$324.6 million at December 31, 2018 based on the last traded or broker quoted price. We identified investments in fixed income securities, common stock and mutual funds presented within the preneed and perpetual care trust investments categories on our Consolidated Balance Sheet as having met the criteria for fair value measurement.

The following three-level valuation hierarchy based upon the transparency of inputs is utilized in the measurement and valuation of financial assets or liabilities as of the measurement date:

- Level 1—Fair value of securities based on unadjusted quoted prices for identical assets or liabilities in active markets. Our investments classified as Level 1 securities include cash, common stock and U.S. treasury debt;
- Level 2—Fair value of securities estimated based on quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable or that can be corroborated by observable market data by correlation. These inputs include interest rates, yield curves, credit risk, prepayment speeds, rating and tax-exempt status. Our investments classified as Level 2 securities include municipal bonds, corporate debt, preferred stocks, foreign debt, mortgage-backed securities, fixed income mutual funds and other investments.
- Level 3—Unobservable inputs based upon the reporting entity’s internally developed assumptions, which market participants would use in pricing the asset or liability. As of December 31, 2017 and 2018, we did not have any assets that had fair values determined by Level 3 inputs and no liabilities measured at fair value.

We account for our investments as available-for-sale and measure them at fair value under standards of financial accounting and reporting for investments in equity instruments that have readily determinable fair values and for all investments in debt securities. See Notes 7 and 11 to our Consolidated Financial Statements herein for the fair value hierarchy levels of our trust investments.

13. INTANGIBLE AND OTHER NON-CURRENT ASSETS

Intangible and other non-current assets at December 31, 2017 and 2018 were as follows (in thousands):

	<u>December 31, 2017</u>	<u>December 31, 2018</u>
Prepaid agreements not-to-compete, net of accumulated amortization of \$6,051 and \$6,672, respectively	\$ 3,730	\$ 4,048
Tradenames	14,372	17,635
Capitalized commissions on preneed contracts, net of accumulated amortization of \$599	—	2,717
Other	15	25
Intangible and other non-current assets	<u>\$ 18,117</u>	<u>\$ 24,425</u>

Prepaid agreements not-to-compete are amortized over the term of the respective agreements, ranging generally from one to ten years. Amortization expense was approximately \$0.4 million, \$0.6 million and \$0.6 million for the years ended December 31, 2016, 2017 and 2018, respectively. During the years ended December 31, 2017 and 2018, we increased prepaid agreements not-to-compete by \$0.9 million and \$0.8 million related to our 2017 and 2018 acquisitions described in Note 3 to the Consolidated Financial Statements included herein.

Our tradenames have indefinite lives and therefore are not amortized. During the years ended December 31, 2017 and 2018, we increased tradenames by \$2.7 million and \$3.3 million related to our 2017 and 2018 acquisitions described in Note 3 to the Consolidated Financial Statements included herein. During 2016, we recorded an impairment to tradenames of \$145,000 related to a funeral home business held for sale as the carrying value exceeded fair value. We did not record an impairment to tradenames in the years ended December 31, 2017 and 2018. See Note 1 to the Consolidated Financial Statements included herein, for a discussion of the methodology used for our annual indefinite-lived intangible asset impairment test.

Topic 606 impacted our accounting for selling costs related to preneed cemetery merchandise and services and preneed funeral trust contracts. Under Topic 606, these costs are capitalized and amortized over the average maturity period for our preneed cemetery contracts and preneed funeral trust contracts. We estimate an average maturity period of eight years for preneed cemetery contracts and ten years for preneed funeral trust contracts. These costs are included in *Intangible and other non-current assets* on our Consolidated Balance Sheet at December 31, 2018. Previously, these costs were expensed in the period incurred. Amortization

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

expense for our capitalized commissions on preneed contracts was \$0.6 million for the year ended December 31, 2018. See Note 2 to the Consolidated Financial Statements included herein for additional information on our opening balance sheet entry on January 1, 2018 to *Intangible and other non-current assets* related to these capitalized commissions on preneed contracts.

On September 30, 2018, our management agreement with a Florida municipality expired and as a result, we ceased to operate three of our cemetery businesses. We recorded a loss of approximately \$125,000 in *Other, net*, for the write-off of capitalized commissions related to these three cemetery businesses. See Note 5 to the Consolidated Financial Statements included herein for additional information regarding the expired management agreement for these three cemetery businesses.

14. LONG-TERM DEBT

On April 25, 2018, we entered into an eighth amendment and commitment increase (the “Eighth Amendment”) to our former secured credit facility, dated as of August 30, 2012 (as amended, the “Former Credit Agreement”), which amended the Former Credit Agreement as follows:

(i) increase the aggregate revolving credit commitment to \$200.0 million;

(ii) permit the Company to use the proceeds of revolving loans (a) to repay certain indebtedness; (b) for working capital and acquisitions; (c) to make certain capital expenditures; (d) to pay interest on certain subordinated indebtedness and refinancing indebtedness (subject to the satisfaction of certain terms and conditions); (e) to prepay, repay, purchase or redeem certain subordinated indebtedness; and (f) for general corporate purposes;

(iii) modify the maximum senior secured leverage ratio covenant; and

(iv) release the mortgage liens of the Administrative Agent on certain real property collateral located in a flood plain, among other things.

Following the effectiveness of the Eighth Amendment, the Former Credit Agreement was comprised of a \$200.0 million revolving credit facility and a \$150.0 million term loan. Under the Former Credit Agreement, as amended by the Eighth Amendment, we were required to comply with a covenant to maintain a maximum senior secured leverage ratio. We incurred \$0.7 million in transaction costs related to the Eighth Amendment of our Former Credit Agreement, which were recorded in *Net loss on early extinguishment of debt*.

On May 7, 2018, we used the remaining capacity under the Former Credit Agreement from the Eighth Amendment to fund the cash consideration used in our privately-negotiated exchanges of approximately 80% of the then outstanding aggregate principal amount of our 2.75% convertible subordinated notes due March 15, 2021 (the “Convertible Notes”). We recognized (i) a net gain of \$1.2 million related to the acquisition of our Convertible Notes; and (ii) a loss of \$0.5 million related to transaction costs incurred for the acquisition of our Convertible Notes, all of which were recorded in *Net loss on early extinguishment of debt*. See Note 15 to the Consolidated Financial Statements included herein for further discussion of the acquisition of our Convertible Notes.

On May 31, 2018, we completed the issuance of \$325.0 million in aggregate principal amount of 6.625% senior notes due 2026 (the “Senior Notes”). See Note 16 to the Consolidated Financial Statements included herein for further discussion of the sale of the Senior Notes.

On May 31, 2018, we used \$291.4 million of the net proceeds from the sale of the Senior Notes to repay all amounts outstanding under our Former Credit Agreement and all commitments thereunder were terminated. In connection with the repayment in full of all amounts due thereunder, the Former Credit Agreement was retired and \$2.0 million of letters of credit previously issued under the Former Credit Agreement were deemed issued under (and remain outstanding under) the New Credit Facility (as defined below). We did not incur any material early termination penalties in connection with the repayment of the Former Credit Agreement. In connection with the termination of the Former Credit Agreement, we recognized (i) a loss of \$0.7 million related to the Eighth Amendment transaction costs; and (ii) a loss of \$0.9 million of unamortized debt issuance costs related to the Former Credit Agreement, all of which were recorded in *Net loss on early extinguishment of debt*.

For the year ended December 31, 2018, we recognized a net loss of \$0.9 million, which was recorded in *Net loss on early extinguishment of debt* and consisted of the following: (i) a loss of \$1.6 million related to our Former Credit Agreement (discussed above); and (ii) a net gain of \$0.7 million related to the acquisition of our Convertible Notes (discussed above).

On May 31, 2018, in connection with the issuance of the Senior Notes, we entered into a new \$150.0 million senior secured revolving credit facility (the “New Credit Facility”) with the financial institutions party thereto, as lenders, and Bank of America, N.A., as administrative agent. Our obligations under the New Credit Facility are unconditionally guaranteed on a joint and several basis by the same subsidiaries which guarantee the Senior Notes and certain of our subsequently acquired or organized domestic subsidiaries (collectively, the “Credit Facility Guarantors”).

At closing of the New Credit Facility, we had no outstanding borrowings under the New Credit Facility and \$148.0 million of availability after giving effect to the \$2.0 million of letters of credit previously issued under the Former Credit Agreement that

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

were deemed issued under (and remain outstanding under) the New Credit Facility. The New Credit Facility includes an accordion feature allowing for future increases in the facility size by an additional amount of up to \$75.0 million. The New Credit Facility matures on May 31, 2023.

On November 8, 2018, we entered into a first amendment (the “Amendment”) to the New Credit Facility. The Amendment (i) modified the definition of “EBITDA” in the New Credit Facility to increase from \$1,000,000 to \$2,000,000 the aggregate amount of severance costs that may be added back to Net Income (as defined in the New Credit Facility) when calculating EBITDA for any period, and (ii) modified the negative covenant restriction on Restricted Payments (as defined in the New Credit Facility) to permit us to acquire or purchase Equity Interests (as defined in the New Credit Facility) subject to the satisfaction of certain conditions and provided that, if before and after giving pro-forma effect to such acquisition or purchase the Total Leverage Ratio (as defined in the New Credit Facility) is (x) equal to or greater than 4.50 to 1.00 but less than or equal to 5.25 to 1.00, then the aggregate amount may not exceed \$30,000,000 during the term of the New Credit Facility, and (y) less than 4.50 to 1.00, then the aggregate amount is unlimited.

We incurred \$1.1 million in transactions costs related to our New Credit Facility, which were capitalized and will be amortized over the remaining term of the related debt using the straight-line method.

The New Credit Facility is secured by a first-priority perfected security interest in and lien on substantially all of our personal property assets and those of the Credit Facility Guarantors, and includes provisions which require us and such subsidiaries, upon the occurrence of an event of default under the New Credit Facility, to grant additional liens on real property assets accounting for no less than 50% of our and the Credit Facility Guarantors' funeral operations.

The New Credit Facility contains customary affirmative covenants, including, but not limited to, covenants with respect to the use of proceeds, payment of taxes and other obligations, continuation of our business and the maintenance of existing rights and privileges, the maintenance of property and insurance, amongst others.

In addition, the New Credit Facility also contains customary negative covenants, including, but not limited to, covenants that, among other things, restrict (subject to certain exceptions) our ability and the Credit Facility Guarantor's ability to incur indebtedness, grant liens, make investments, engage in acquisitions, mergers or consolidations, and pay dividends and other restricted payments, and the following financial covenants: a total leverage ratio not to exceed 5.50 to 1.00, and a fixed charge coverage ratio of not less than 1.20 to 1.00 as of the end of any period of four consecutive fiscal quarters. We will calculate the financial covenants on a consolidated basis.

Our long-term debt consisted of the following at December 31, 2017 and 2018 (in thousands):

	December 31, 2017	December 31, 2018
New Credit Facility	\$ —	\$ 27,100
Revolving credit facility	92,000	—
Term loan	127,500	—
Acquisition debt	10,548	8,940
Debt issuance costs, net of accumulated amortization of \$4,442 and \$108	(967)	(955)
Less: current portion	(16,927)	(2,015)
Total long-term debt	<u>\$ 212,154</u>	<u>\$ 33,070</u>

As of December 31, 2018, we had outstanding borrowings under the New Credit Facility of \$27.1 million. We had one letter of credit issued on November 30, 2018 and outstanding under the New Credit Facility for approximately \$2.0 million, which bears interest at 2.125% and will expire on November 25, 2019. The letter of credit automatically renews annually and secures our obligations under our various self-insured policies. Outstanding borrowings under our New Credit Facility bear interest at either a prime rate or a LIBOR rate, plus an applicable margin based upon our leverage ratio. As of December 31, 2018, the prime rate margin was equivalent to 0.875% and the LIBOR margin was 1.875%. The weighted average interest rate on our New Credit Facility for the six months ended December 31, 2018 was 0.4%. For the six months ended June 30, 2018, the weighted average interest rate on our Former Credit Agreement was 4.0%.

We have no material assets or operations independent of our subsidiaries. All assets and operations are held and conducted by subsidiaries, each of which have fully and unconditionally guaranteed our obligations under the New Credit Facility. Additionally, we do not currently have any significant restrictions on our ability to receive dividends or loans from any New Credit Facility Guarantors.

We were in compliance with the covenants contained in our New Credit Facility as of December 31, 2018, with a leverage ratio of 5.10 to 1.00 and a fixed charge coverage ratio of 1.84 to 1.00.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Acquisition debt consists of deferred purchase price and promissory notes payable to sellers. A majority of the deferred purchase price and notes bear interest at 0% and are discounted at imputed interest rates ranging from 7.3% to 10.0%. Original maturities range from five to twenty years. Imputed interest expense related to our acquisition debt was \$0.5 million, \$0.9 million and \$0.8 million for the years ended December 31, 2016, 2017 and 2018, respectively.

Amortization of debt issuance costs related to our New Credit Facility was \$0.1 million for the year ended December 31, 2018. Amortization of debt issuance costs related to our Former Credit Agreement was \$0.4 million, \$0.3 million and \$0.1 million for the years ended December 31, 2016, 2017 and 2018, respectively.

The aggregate maturities of our long-term debt for the next five years subsequent to December 31, 2018 and thereafter are as follows (in thousands):

Years ending December 31,

2019	\$	2,015
2020		1,298
2021		1,046
2022		553
2023		27,689
2024 and thereafter		3,439
Total	\$	<u>36,040</u>

15. CONVERTIBLE SUBORDINATED NOTES

On March 19, 2014, we issued \$143.75 million aggregate principal amount of our Convertible Notes. The Convertible Notes have not been registered under the Securities Act of 1933, as amended (the “Securities Act”), and were offered only to “qualified institutional buyers” in compliance with Rule 144A under the Securities Act. The Convertible Notes are governed by an indenture dated as of March 19, 2014 between Wilmington Trust, National Association, as Trustee, and us. The Convertible Notes bear interest at 2.75% per year. Interest on the Convertible Notes began to accrue on March 19, 2014 and is payable semi-annually in arrears on March 15 and September 15 of each year.

On May 7, 2018, we completed our exchange (the “Exchange”) of approximately \$115.0 million in aggregate principal amount of Convertible Notes, which represented approximately 80% of the aggregate principal amount of our Convertible Notes then outstanding, in privately-negotiated exchange agreements with a limited number of convertible noteholders, for \$74.8 million in cash (plus accrued interest of \$0.4 million totaling \$75.2 million) and 2,822,859 newly issued shares of our common stock, par value \$.01 per share, pursuant to a private placement in reliance on Section 4(a)(2) of the Securities Act. The cash portion of the exchange consideration was funded from our Former Credit Agreement as amended by the Eighth Amendment. Following the settlement of the Convertible Notes exchange, the aggregate principal amount of our Convertible Notes outstanding was reduced to \$28.8 million. See Note 14 to the Consolidated Financial Statements included herein for further discussion of our Former Credit Agreement.

On December 24, 2018, we completed privately-negotiated repurchases of an additional \$22.4 million in aggregate principal amount of Convertible Notes, which represented 78% of the aggregate principal amount of our Convertible Notes then outstanding for \$22.9 million in cash (plus accrued interest of approximately \$0.2 million totaling \$23.0 million). The consideration for the repurchases was funded from our New Credit Facility. Following these repurchases, the aggregate principal amount of our Convertible Notes outstanding was reduced to \$6.3 million.

We recognized a net gain of \$1.7 million, which was recorded in *Net loss on early extinguishment of debt*, related to the May exchange and December repurchases of our Convertible Notes. The gain is composed of a difference of \$3.1 million between the fair value and the carrying amount of the liability component of our Convertible Notes immediately preceding each exchange and repurchase, as applicable, partially offset by a write-off of \$1.4 million in unamortized debt issuance costs related to the exchange and repurchase of our Convertible Notes. The gain does not include the impact of any transaction costs we incurred to exchange and repurchase the Convertible Notes.

We incurred \$0.9 million in transactions costs related to the exchange and repurchase of our Convertible Notes, of which \$0.6 million was expensed and recorded in *Net loss on early extinguishment of debt* and \$0.3 million was allocated to the equity component and recorded in *Additional paid-in capital*.

The Convertible Notes are general unsecured obligations and are subordinated in the right of payment to all of our existing and future senior indebtedness and equal in right of payment with our other existing and future subordinated indebtedness. The initial conversion rate of the Convertible Notes as of March 19, 2014, was 44.3169 shares of our common stock per \$1,000 principal amount of Convertible Notes, equivalent to an initial conversion price of \$22.56 per share of common stock. The conversion rate

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

is subject to adjustment upon the occurrence of certain events, as described in the indenture governing the Convertible Notes. During 2017, an adjustment to the conversion rate of the Convertible Notes was triggered when our Board increased the dividends declared per common share from \$0.05 per share to \$0.075 per share. At December 31, 2018, the adjusted conversion rate of the Convertible Notes is 45.0228 shares of our common stock per \$1,000 principal amount of Convertible Notes, equivalent to an adjusted conversion price of \$22.21 per share of common stock.

Equity issuance costs are included in *Additional paid-in capital* on our Consolidated Balance Sheet and are not amortized. Additionally, the recognition of the Convertible Notes as two separate components results in a basis difference associated with the liability component which represents a temporary tax difference. As a result, we recognized a deferred tax liability of \$12.7 million related to this temporary difference which was recorded as a reduction to *Additional paid-in capital* and an increase to our deferred tax liability. The deferred tax liability is being amortized over the seven year term of the Convertible Notes. At December 31, 2018, the balance of our deferred tax liability related to our Convertible Notes was \$0.1 million.

The carrying values of the liability and equity components of the Convertible Notes at December 31, 2017 and 2018 are reflected on our Consolidated Balance Sheet as follows (in thousands):

	<u>December 31, 2017</u>	<u>December 31, 2018</u>
Long-term liabilities:		
Principal amount	\$ 143,750	\$ 6,346
Unamortized discount of liability component	(17,559)	(560)
Convertible Notes issuance costs, net of accumulated amortization of \$1,877 and \$106, respectively	(1,750)	(54)
Carrying value of the liability component	<u>\$ 124,441</u>	<u>\$ 5,732</u>
Carrying value of the equity component	<u>\$ 17,973</u>	<u>\$ 789</u>

The Carrying value of the liability component and the Carrying value of the equity component are recorded in *Convertible subordinated notes due 2021* and *Additional paid-in capital*, respectively, on our Consolidated Balance Sheet at December 31, 2017 and 2018.

The fair value of the Convertible Notes, which are Level 2 measurements, was \$6.2 million at December 31, 2018.

Interest expense on the Convertible Notes included contractual coupon interest expense of \$4.0 million, \$4.0 million and \$1.9 million for the years ended December 31, 2016, 2017 and 2018, respectively. Accretion of the discount on the Convertible Notes was \$3.9 million, \$4.3 million and \$2.2 million for the years ended December 31, 2016, 2017 and 2018, respectively. Amortization of debt issuance costs related to our Convertible Notes was \$0.5 million, \$0.5 million and \$0.2 million for the years ended December 31, 2016, 2017 and 2018, respectively.

The remaining unamortized debt discount and the remaining unamortized debt issuance costs are being amortized using the effective interest method over the remaining term of approximately 26 month of the Convertible Notes. The effective interest rate on the unamortized debt discount for the years ended December 31, 2017 and 2018 was 11.3% and 11.4%, respectively. The effective interest rate on the unamortized discount and the debt issuance costs for both years ended December 31, 2017 and 2018 was 3.2%.

The aggregate maturities of our Convertible Notes for the five years subsequent to December 31, 2018 are as follows (in thousands):

	<u>Principal Maturity</u>	<u>Discount Amortization</u>	<u>Present Value</u>
Years ending December 31,			
2019	\$ —	\$ (242)	\$ (242)
2020	—	(270)	(270)
2021	6,346	(48)	6,298
2022	—	—	—
2023	—	—	—
Total	<u>\$ 6,346</u>	<u>\$ (560)</u>	<u>\$ 5,786</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

16. SENIOR NOTES

On May 31, 2018, we completed the issuance of \$325.0 million in aggregate principal amount of our Senior Notes and related guarantees in a private offering under Rule 144A and Regulation S under the Securities Act.

We received proceeds of \$320.1 million, net of a 1.5% debt discount of \$4.9 million, of which we used \$291.4 million to repay our existing indebtedness under our Former Credit Agreement and intend to use the remaining net proceeds for general corporate purposes, including acquisitions. We incurred \$1.4 million in transaction costs related to the Senior Notes. See Note 14 to the Consolidated Financial Statements included herein for further discussion of the repayment of our Former Credit Agreement.

The Senior Notes were issued under an indenture, dated as of May 31, 2018 (the “Indenture”), among us, certain of our existing subsidiaries (collectively, the “Subsidiary Guarantors”), as guarantors, and Wilmington Trust, National Association., as trustee.

The Senior Notes bear interest at 6.625% per year. Interest on the Senior Notes began to accrue on May 31, 2018 and is payable semi-annually in arrears on June 1 and December 1 of each year, beginning on December 1, 2018 to holders of record on each May 15 and November 15 preceding an interest payment date. The Senior Notes mature on June 1, 2026, unless earlier redeemed or repurchased. The Senior Notes are unsecured, senior obligations and are fully and unconditionally guaranteed on a senior unsecured basis, jointly and severally, by certain of our existing subsidiaries.

We may redeem all or part of the Senior Notes at any time prior to June 1, 2021 at a redemption price equal to 100% of the principal amount of Senior Notes redeemed, plus a “make whole” premium, and accrued and unpaid interest, if any, to the date of redemption. We have the right to redeem the Senior Notes at any time on or after June 1, 2021 at the redemption prices described in the Indenture, plus accrued and unpaid interest, if any, to the date of redemption. Additionally, at any time before June 1, 2021, we may redeem up to 40% of the aggregate principal amount of the Senior Notes issued with an amount equal to the net proceeds of certain equity offerings, at a price equal to 106.625% of the principal amount of the Senior Notes, plus accrued and unpaid interest, if any, to the date of redemption; provided that (1) at least 60% of the aggregate principal amount of the Senior Notes (including any additional Senior Notes) originally issued under the Indenture remain outstanding immediately after the occurrence of such redemption (excluding Senior Notes held by us); and (2) each such redemption must occur within 180 days of the date of the closing of each such equity offering.

If a “change of control” occurs, holders of the Senior Notes will have the option to require us to purchase for cash all or a portion of their Senior Notes at a price equal to 101% of the principal amount of the Senior Notes, plus accrued and unpaid interest. In addition, if we make certain asset sales and do not reinvest the proceeds thereof or use such proceeds to repay certain debt, we will be required to use the proceeds of such asset sales to make an offer to purchase the Senior Notes at a price equal to 100% of the principal amount of the Senior Notes, plus accrued and unpaid interest.

The Indenture contains restrictive covenants limiting our ability and our Restricted Subsidiaries (as defined in the Indenture) to, among other things, incur additional indebtedness or issue certain preferred shares, create liens on certain assets to secure debt, pay dividends or make other equity distributions, purchase or redeem capital stock, make certain investments, sell assets, agree to certain restrictions on the ability of Restricted Subsidiaries to make payments to us, consolidate, merge, sell or otherwise dispose of all or substantially all assets, or engage in transactions with affiliates. The Indenture also contains customary events of default.

The debt discount of \$4.9 million and the debt issuance costs of \$1.4 million are being amortized using the effective interest method over the remaining term of approximately 89 months of the Senior Notes. The effective interest rate on the unamortized debt discount and the unamortized debt issuance costs for year ended December 31, 2018 was 6.87% and 6.69%, respectively.

The carrying value of the Senior Notes at December 31, 2018 are reflected in our Consolidated Balance Sheet as follows (in thousands):

	<u>December 31, 2018</u>
Long-term liabilities:	
Principal amount	\$ 325,000
Debt discount, net of accumulated amortization of \$273	(4,602)
Debt issuance costs, net of accumulated amortization of \$77	(1,290)
Carrying value of the Senior Notes	<u>\$ 319,108</u>

The fair value of the Senior Notes, which are Level 2 measurements, was \$324.6 million at December 31, 2018.

Interest expense on the Senior Notes included contractual coupon interest expense of \$12.6 million for the year ended December 31, 2018. Amortization of the debt discount on the Senior Notes was \$0.3 million for the year ended December 31, 2018 and amortization of debt issuance costs on the Senior Notes was \$0.1 million for the year ended December 31, 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The aggregate maturities of our Senior Notes for the five years subsequent to December 31, 2018 are as follows (in thousands):

	<u>Principal Maturity</u>	<u>Discount Amortization</u>	<u>Present Value</u>
Years ending December 31,			
2019	\$ —	\$ (493)	\$ (493)
2020	—	(528)	(528)
2021	—	(565)	(565)
2022	—	(605)	(605)
2023	—	(648)	(648)
Thereafter	325,000	(1,763)	323,237
Total	<u>\$ 325,000</u>	<u>\$ (4,602)</u>	<u>\$ 320,398</u>

17. COMMITMENTS AND CONTINGENCIES

Leases

We lease certain office facilities, certain funeral homes and equipment under operating leases with original terms ranging from one to nineteen years. Certain of these leases provide for an annual rent adjustment and contain options for renewal. Rent expense totaled \$6.1 million, \$6.1 million and \$6.0 million for the years ended December 31, 2016, 2017 and 2018, respectively. Assets acquired under capital leases are included in *Property, plant and equipment* in our accompanying Consolidated Balance Sheet in the amount of \$6.6 million in 2017 and \$6.2 million in 2018, net of accumulated depreciation. Capital lease obligations are included in the current portion and non-current portion of long-term debt and capital lease obligations in our Consolidated Balance Sheet. At December 31, 2018, future minimum lease payments under non-cancelable lease agreements were as follows (in millions):

	<u>Future Minimum Lease Payments</u>	
	<u>Operating Leases</u>	<u>Capital Leases</u>
Years ending December 31,		
2019	\$ 3.7	\$ 0.9
2020	3.2	0.8
2021	2.7	0.8
2022	0.5	0.8
2023	0.3	0.9
Thereafter	1.1	7.1
Total future minimum lease payments	<u>\$ 11.5</u>	<u>\$ 11.3</u>
Less: amount representing interest (rates ranging from 7.0% to 11.5%)		(4.9)
Less: current portion of obligations under capital leases		(0.3)
Long-term obligations under capital leases		<u>\$ 6.1</u>

Non-Compete, Consulting and Employment Agreements

We have various non-compete agreements with former owners and employees. These agreements are generally for one to ten years and provide for periodic future payments over the term of the agreements.

We have various consulting agreements with former owners of businesses we have acquired. Payments for such agreements are generally not made in advance. These agreements are generally for one to five years and provide for bi-weekly or monthly payments.

We have employment agreements with certain of our executive officers and senior leadership. These agreements are generally for three to five years and provide for participation in various incentive compensation arrangements. These agreements generally renew automatically on an annual basis after their initial term has expired.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

At December 31, 2018, the maximum estimated future cash commitments under these agreements with remaining commitment terms, and with original terms of more than one year, are as follows (in millions):

Years ending December 31,	Non-Compete	Consulting	Employment ^(a)	Total
2019	\$ 1.9	\$ 0.9	\$ 1.9	\$ 4.7
2020	1.6	0.7	1.2	3.5
2021	1.5	0.6	0.9	3.0
2022	1.1	0.4	0.8	2.3
2023	0.7	0.2	0.7	1.6
Thereafter	1.3	—	0.2	1.5
Total	\$ 8.1	\$ 2.8	\$ 5.7	\$ 16.6

- (a) Melvin C. Payne, our Chairman of the Board and Chief Executive Officer, has an employment agreement that does not renew after the initial term of five years.

401(K) Plan

We sponsor a defined contribution plan (401K) for the benefit of our employees. Matching contributions and plan administrative expenses totaled \$1.8 million, \$1.9 million and \$2.1 million for 2016, 2017 and 2018, respectively. We do not offer any post-retirement or post-employment benefits.

Litigation

We are a party to various litigation matters and proceedings. For each of our outstanding legal matters, we evaluate the merits of the case, our exposure to the matter, possible legal or settlement strategies, and the likelihood of an unfavorable outcome. If we determine that an unfavorable outcome is probable and can be reasonably estimated, we establish the necessary accruals. We hold certain insurance policies that may reduce cash outflows with respect to an adverse outcome of certain of these litigation matters.

Faria, et al. v. Carriage Funeral Holdings, Inc., Superior Court of California, Contra Costa County, Case No. MSC18-00606. On March 26, 2018, six Plaintiffs filed a putative class action against Carriage Funeral Holdings, Inc., our subsidiary, their alleged employer, on behalf of themselves and all similarly situated current and former employees. Plaintiffs seek monetary damages and claim that Carriage Funeral Holdings, Inc. failed to pay minimum wages, provide meal and rest breaks, provide accurately itemized wage statements, reimburse employees for required expenses, and provide wages when due. Plaintiffs also claim that Carriage Funeral Holdings, Inc. violated California Business and Professions Code §17200 et seq. On June 5, 2018, Plaintiffs filed a First Amended Complaint to add a claim under the California Private Attorney General Act. On October 23, 2018, the parties mediated this matter and executed a Memorandum of Understanding for class settlement. In February 2019, a Class Action Settlement Agreement was fully executed, which will be submitted to the Court for preliminary approval. We anticipate that the Court will preliminarily approve the Class Action Settlement Agreement in 2019. If the Class Action Settlement Agreement is preliminarily approved by the Court, the class claims process will then proceed. At December 31, 2018, we have accrued \$650,000 for the estimated settlement amount related to this case.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

18. INCOME TAXES

The provision (benefit) for income taxes for the years ended December 31, 2016, 2017 and 2018 consisted of the following (in thousands):

	Year Ended December 31,		
	2016	2017	2018
Current:			
U. S. federal provision	\$ 6,609	\$ 6,425	\$ 1,489
State provision	1,195	815	1,309
Total current provision	\$ 7,804	\$ 7,240	\$ 2,798
Deferred:			
U. S. federal provision (benefit)	\$ 3,475	\$ (12,881)	\$ 2,831
State provision	1,381	1,230	992
Total deferred provision (benefit)	\$ 4,856	\$ (11,651)	\$ 3,823
Total income tax provision (benefit)	\$ 12,660	\$ (4,411)	\$ 6,621

A reconciliation of taxes calculated at the U.S. federal statutory rate to those reflected in the Consolidated Statements of Operations for the years ended December 31, 2016, 2017 and 2018 is as follows (dollars in thousands):

	Year Ended December 31,					
	2016		2017		2018	
	Amount	Percent	Amount	Percent	Amount	Percent
Federal statutory rate	\$ 11,300	35.0 %	\$ 11,474	35.0 %	\$ 3,834	21.0 %
Effect of state income taxes, net of federal benefit	1,127	3.5	1,304	4.0	1,776	9.7
Effect of non-deductible expenses and other, net	213	0.7	(36)	(0.1)	1,451	7.9
Change in valuation allowance	20	0.1	23	0.1	26	0.1
Re-measurement of deferred taxes due to tax reform	—	—	(17,176)	(52.4)	(466)	(2.5)
Total	\$ 12,660	39.3 %	\$ (4,411)	(13.5) %	\$ 6,621	36.2 %

On May 10, 2017, we filed amended federal returns for the tax years ending December 31, 2013, 2014 and 2015, which generated significant refunds. As a result, on July 18, 2017, we received notification that the IRS selected our tax years ended December 31, 2013, 2014 and 2015 for a limited scope examination to verify the refunds due. The examinations are in process, however, the timing of the conclusion of the audit is uncertain. The federal statute is still open for our 2016 tax year.

On December 21, 2018, we filed 3 Form 3115s, Application for Change in Accounting Method, and associated statements with the requesting consent to change the method of accounting for deferred revenue for our cemetery property and cemetery merchandise and service operations for the taxable year beginning January 1, 2018 and ending December 31, 2018. The application requesting a change in the method of accounting for recognizing advance payments received under preneed contracts for cemetery services and merchandise is to comply with Internal Revenue Code (I.R.C.) Sections 61, 451, and 471. The change in method of accounting for constructed and unconstructed cemetery property is to comply with I.R.C Sections 61, 451, 1001, 1012 and 460. The method changes filed are non-automatic and require IRS approval. The impact of the change in the method of accounting for deferred revenue will be recorded in the interim period in which the method changes are approved. The method changes are expected to be approved but the timing of the approval is uncertain. Additionally, once approved the method changes will result in significant favorable deductions and will have a favorable impact on cash taxes paid during 2019.

We do not have any unrecognized tax benefits recorded as of December 31, 2018 and we do not anticipate a material change in our unrecognized tax benefits during the next twelve months.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The tax effects of temporary differences from total operations that give rise to significant deferred tax assets and liabilities at December 31, 2017 and 2018 were as follows (in thousands):

	Year Ended December 31,	
	2017	2018
Deferred income tax assets:		
Net operating loss carryforwards	\$ 1,978	\$ 1,569
Tax credit carryforwards	133	133
State bonus depreciation	494	970
Accrued liabilities and other	6,136	7,544
Amortization of non-compete agreements	873	1,135
Preneed liabilities, net	5,239	4,242
Total deferred income tax assets	<u>14,853</u>	<u>15,593</u>
Less valuation allowance	(244)	(276)
Total deferred income tax assets	<u>\$ 14,609</u>	<u>\$ 15,317</u>
Deferred income tax liabilities:		
Depreciation and amortization	\$ (41,447)	\$ (46,205)
Convertible subordinated notes due 2021	(4,096)	(131)
Prepays and other	(225)	(244)
Total deferred income tax liabilities	<u>(45,768)</u>	<u>(46,580)</u>
Total net deferred tax liabilities	<u>\$ (31,159)</u>	<u>\$ (31,263)</u>
Current deferred tax asset	\$ —	\$ —
Non-current deferred tax liabilities	(31,159)	(31,263)
Total net deferred tax liabilities	<u>\$ (31,159)</u>	<u>\$ (31,263)</u>

Our deferred tax assets and liabilities, along with related valuation allowances are classified as non-current on our Consolidated Balance Sheet at December 31, 2017 and 2018.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Act. Effective as of January 1, 2018, the Tax Act established new tax laws, including but not limited to (1) a reduction of the corporate tax rate from a top marginal rate of 35% to a flat rate of 21%; (2) a limitation of the tax deduction for interest expense to 30% of adjusted earnings (except for certain small businesses); (3) a limitation of the deduction for net operating losses to 80% of current year taxable income and elimination of net operating loss carrybacks; (4) limitations of certain executive compensation deductions; and (5) limitations or repeals of many business deductions and credits.

The analysis required by SAB 118 to determine the impact of the Tax Act was complete as of December 31, 2017. Return to provision adjustments recorded in the fourth quarter of 2018 resulted in additional favorable impact from the rate reduction as there were changes to the deferred balances recorded.

We record a valuation allowance to reflect the estimated amount of deferred tax assets for which realization is uncertain. Management reviews the valuation allowance at the end of each quarter and makes adjustments if it is determined that it is more likely than not that the tax benefits will be realized. We recognized an immaterial net increase in our valuation allowance during 2018 and 2017.

For federal income tax reporting purposes, we have no net operating loss carryforwards. For state reporting purposes, we have \$31.2 million of net operating loss carryforwards that will expire between 2019 and 2037, if not utilized. Based on management's assessment of the various state net operating losses, it was determined that it is more likely than not that we will be able to realize tax benefits on some portion of the amount of the state losses. The valuation allowance at December 31, 2018 was attributable to the deferred tax asset related to a portion of the state operating losses.

We analyze tax benefits for uncertain tax positions and how they are to be recognized, measured, and derecognized in financial statements; provide certain disclosures of uncertain tax matters; and specify how reserves for uncertain tax positions should be classified on our Consolidated Balance Sheet.

At December 31, 2018, no uncertain tax positions were identified and we do not anticipate a material change to our unrecognized tax benefits during the next twelve months.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	Year Ended December 31,		
	2016	2017	2018
Unrecognized tax benefit at beginning of year	\$ 814	\$ —	\$ —
Reductions based on tax positions related to the prior year	(17)	—	—
Reductions for tax year 2011 federal audit	(568)	—	—
Reductions based on tax positions related to the current year	(229)	—	—
Reductions as a result of a lapse of the applicable statute of limitations	—	—	—
Unrecognized tax benefit at end of year	\$ —	\$ —	\$ —

19. STOCKHOLDERS' EQUITY

Share Authorization

We are authorized to issue 80,000,000 shares of common stock, \$0.01 per share par value. We had 22,622,242 and 25,703,490 shares issued and outstanding, net of 6,523,370 and 7,625,339 shares held in treasury at par, at December 31, 2017 and 2018, respectively.

Stock Based Compensation Plans

During the year ended December 31, 2018, we had two stock benefits plans in effect under which stock, restricted stock, stock options and performance awards have been granted or remain outstanding: the Second Amended and Restated 2006 Long-Term Incentive Plan (the "Amended and Restated 2006 Plan") and the 2017 Omnibus Incentive Plan (the "2017 Plan"). The Amended and Restated 2006 Plan was terminated upon the approval of the 2017 Plan at the annual shareholders meeting on May 17, 2017. The termination of the Amended and Restated 2006 Plan does not affect the awards previously issued and outstanding.

All stock-based plans are administered by the Compensation Committee appointed by our Board of Directors (the "Board"). The 2017 Plan provides for grants of options as non-qualified options or incentive stock options, restricted stock and performance awards. The 2017 Plan expires on May 17, 2027.

The status of each of the plans at December 31, 2018 is as follows (shares in thousands):

	Shares Reserved	Shares Available to Issue	Options Outstanding
Amended and Restated 2006 Plan	—	—	1,341
2017 Plan	2,263 ⁽¹⁾	2,075	182
Total	2,263	2,075	1,523

(1) Amount includes approximately 708,000 shares granted from the Amended and Restated 2006 Plan that were returned to the Company due to cancellations, to pay taxes on restricted stock vestings and to pay option price and taxes on option exercises.

Restricted Stock

During 2018, we issued restricted stock to certain employees totaling 86,260 shares that vest over a three year period and had an aggregate grant date market value of \$2.2 million. In 2017, a total of 27,250 shares of restricted stock were awarded with a grant date market value of \$0.8 million. In 2016, a total of 16,900 shares of restricted stock were awarded with a grant date market value of \$0.3 million.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

A summary of the status of unvested restricted stock as of December 31, 2018, and changes during 2018, is presented below (shares in thousands):

<u>Unvested stock awards</u>	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Unvested at January 1, 2018	54	\$ 24.09
Awards	86	25.18
Vestings	(32)	22.68
Cancellations	(20)	25.41
Unvested at December 31, 2018	<u>89</u>	<u>\$ 25.38</u>

We recorded stock-based compensation expense, which is included in *General, administrative and other* expenses, for restricted stock awards of \$0.7 million, \$0.7 million and \$0.8 million in 2016, 2017 and 2018, respectively.

As of December 31, 2018, we had \$2.3 million of total unrecognized compensation costs related to unvested restricted stock awards, which are expected to be recognized over a weighted average period of approximately 2 years.

Stock Options

During 2018, we granted 212,940 options to our leadership team and certain key employees at a weighted average exercise price of \$25.43. These options will vest in one-fifth increments over a five-year period and have a ten-year term. The fair value of these options was \$1.4 million. In 2017, a total of 461,700 stock options were awarded, the fair value of which was \$3.3 million. In 2016, a total of 235,500 stock options were awarded, the fair value of which was \$1.3 million.

Options are granted with an exercise price equal to the closing price of our common stock on the date of grant. All of the options granted under this plan have either five, seven or ten-year terms. We utilize the Black-Scholes option valuation model for estimating the fair value of our stock options. This model allows the use of a range of assumptions related to volatility, risk-free interest rate, expected holding period and dividend yield. The expected volatility utilized in the valuation model is based on the historical volatility of our stock price. The dividend yield and expected holding period are based on historical experience and management's estimate of future events. The risk-free interest rate is derived from the U.S. Treasury yield curve based on the expected life of the option in effect at the time of grant. The fair values of our stock options were calculated using the following weighted average assumptions, based on the methods described above for the years ended December 31, 2016, 2017 and 2018:

	<u>2016</u>	<u>2017</u>	<u>2018</u>
Dividend yield	0.50%	0.75%	1.18%
Expected volatility	31.21%	29.29%	27.08%
Risk-free interest rate	1.23%	1.95%	2.65%
Expected holding period (years)	5.0	5.0	5.0

A summary of the stock options at December 31, 2016, 2017 and 2018 and changes during the three years ended December 31, 2018 is presented in the table and narrative below (shares in thousands):

	<u>Year Ended December 31,</u>					
	<u>2016</u>		<u>2017</u>		<u>2018</u>	
	<u>Shares</u>	<u>Wtd. Avg. Ex. Price</u>	<u>Shares</u>	<u>Wtd. Avg. Ex. Price</u>	<u>Shares</u>	<u>Wtd. Avg. Ex. Price</u>
Outstanding at beginning of period	1,695	\$ 18.95	1,650	\$ 19.18	1,934	\$ 20.85
Adjustment to beginning balance	18	\$ 18.94	—	\$ —	—	\$ —
Granted	236	\$ 20.06	462	\$ 26.56	213	\$ 25.43
Exercised	(112)	\$ 13.76	(159)	\$ 19.81	(459)	\$ 17.73
Canceled or expired	(187)	\$ 21.30	(19)	\$ 23.17	(165)	\$ 25.34
Outstanding at end of year	<u>1,650</u>	<u>\$ 19.18</u>	<u>1,934</u>	<u>\$ 20.85</u>	<u>1,523</u>	<u>\$ 21.95</u>
Exercisable at end of year	<u>1,106</u>	<u>\$ 18.21</u>	<u>1,225</u>	<u>\$ 18.68</u>	<u>1,001</u>	<u>\$ 20.29</u>

The aggregate intrinsic value of the outstanding and exercisable stock options were both \$1.0 million at December 31, 2018. The total intrinsic value of options exercised during 2016, 2017 and 2018 totaled \$1.2 million, \$1.0 million and \$3.9 million, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The total fair value of stock options vested during 2016, 2017 and 2018 totaled \$2.8 million, \$1.5 million and \$1.5 million, respectively. We recorded stock-based compensation expense, which is included in *General, administrative and other* expenses, for stock options of \$1.7 million, \$1.5 million and \$1.0 million in 2016, 2017 and 2018, respectively.

As of December 31, 2018, there was \$2.4 million of unrecognized compensation cost, net of estimated forfeitures, related to unvested stock options expected to be recognized over a weighted average period of approximately 3.3 years.

The following table further describes our outstanding stock options at December 31, 2018:

Actual Ranges of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/18	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at 12/31/18	Weighted-Average Exercise Price
\$4.78 - \$5.94	105,603	2.50	\$ 5.66	105,603	\$ 5.66
\$16.73 - \$20.49	468,427	2.46	\$ 20.29	382,627	\$ 20.34
\$22.58 - \$26.93	949,100	6.11	\$ 24.58	513,040	\$ 23.26
\$4.78 - \$26.93	1,523,130	4.74	\$ 20.85	1,001,270	\$ 20.29

Performance Awards

During 2018, we granted 113,320 performance awards to our leadership team and certain key employees, payable in shares. The fair value of these performance awards was \$2.9 million and was determined by using the stock price on the grant date of \$25.43. During 2017, we granted 105,540 performance awards to our leadership team and certain key employees, payable in shares. The fair value of these performance awards was \$2.8 million and was determined by using the weighted average stock price on the grant date of \$26.56. During 2016, we granted 73,700 performance awards to our leadership team and certain key employees, payable in shares. The fair value of these performance awards was approximately \$1.6 million and was determined by using a Monte-Carlo simulation pricing model.

These awards will vest over a five year period, provided that certain criteria, including but not limited to, Adjusted Consolidated EBITDA (Adjusted Earnings Before Interest Tax Depreciation and Amortization) and Adjusted Consolidated EBITDA Margin performance is achieved and the individual has remained continuously employed by Carriage through such date. The Adjusted Consolidated EBITDA performance represents 50% of the award and the Adjusted Consolidated EBITDA Margin performance represents 50% of the award.

On November 29, 2018, we cancelled all the Performance Award Agreements previously awarded to all individuals in 2016, 2017 and 2018, which resulted in a write-off of \$3.3 million. Prior to such cancellation, each of the Agreements provided for contingent compensation, which was payable to such individuals in shares of common stock, based on our performance over a five-year period from the date of grant.

We recorded stock-based compensation expense, which is included in *General, administrative and other* expenses, for performance awards of \$0.2 million, \$0.7 million and \$4.4 million in 2016, 2017 and 2018, respectively. The 2018 expense includes the write-off due to the cancellation of the performance awards.

Employee Stock Purchase Plan

We provide all employees the opportunity to purchase common stock through payroll deductions in our ESPP. Purchases are made quarterly; the price being 85% of the lower of the price on the first day of the plan entry date (beginning of the fiscal year) or the actual date of purchase (end of quarter). In 2018, employees purchased a total of 49,938 shares at a weighted average price of \$18.56 per share. In 2017, employees purchased a total of 43,808 shares at a weighted average price of \$22.43 per share. In 2016, employees purchased a total of 44,774 shares at a weighted average price of \$19.48 per share.

We recorded stock-based compensation expense, which is included in *General, administrative and other* expenses, for our ESPP of approximately \$234,000, \$244,000 and \$246,000 in 2016, 2017 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The fair values of the right (option) to purchase shares under the ESPP are estimated at the date of purchase with the four quarterly purchase dates using the following assumptions:

	<u>2016</u>	<u>2017</u>	<u>2018</u>
Dividend yield	0.6%	0.9%	1.4%
Expected volatility	25%	19%	21%
Risk-free interest rate	0.22%, 0.49%, 0.55%, 0.61%	0.53%, 0.65%, 0.77%, 0.89%	1.44%, 1.61%, 1.72%, 1.83%
Expected life (years)	.25, .50, .75, 1.00	.25, .50, .75, 1.00	.25, .50, .75, 1.00

Expected volatilities are based on the historical volatility during the previous twelve months of the underlying common stock. The risk-free rate for the quarterly purchase periods is based on the U.S. Treasury yields in effect at the time of purchase. The expected life of the ESPP grants represents the calendar quarters from the beginning of the year to the purchase date (end of each quarter).

Director Compensation Plans

Our Director Compensation Policy provides for the following: (i) each independent director is entitled to an annual retainer of \$75,000, payable in quarterly installments of \$18,750 each at the end of the quarter; and (ii) the Lead Director and chairman of our Audit Committee are entitled to an additional annual retainer of \$10,000, payable in quarterly installments of \$2,500 each at the end of each quarter, and the chairman of our Corporate Governance and Compensation Committees are entitled to an additional annual retainer of \$5,000, payable in quarterly installments of \$1,250 each at the end of each quarter. Any new independent director will receive upon admission to the Board a grant of \$25,000 (in addition to the independent director annual retainer prorated at the time the new director is admitted to the Board) which can be taken in cash or restricted shares of our common stock. The number of shares of such common stock will be determined by dividing the cash amount by the closing price of our common stock on the date of grant, which will be the date of admission to the Board.

Effective May 16, 2018, our Board revised the Director Compensation Policy such that any Director may elect to receive their annual retainer, which is paid in quarterly installments, in unrestricted shares of our common stock, \$0.01 par value by providing written notice as set forth in the Director Compensation Policy. The number of shares of such common stock shall be determined by dividing the cash amount of the retainer by the closing price of our common stock on the date of grant, which shall be the last business day of each quarter. Such common stock shall vest immediately upon grant. Any written notice to receive the retainer in common stock shall remain effective until notice otherwise is made in writing. Our Board also revised the Director Compensation Policy such that the new Director grant of \$25,000 shall vest immediately. Prior to this change, the stock grant vested 50% immediately and 25% on each of the first and second anniversaries of admission.

Pursuant to the revised Director Compensation Policy described above, for the year ended December 31, 2018, we granted 7,403 shares of our common stock to three Directors, which were valued at \$151,928 at a weighted average stock price of \$20.52.

We recorded compensation expense, which is included in *General, administrative and other* expenses, related to annual retainers and restricted stock awards of \$0.4 million, \$0.4 million and \$0.5 million in 2016, 2017 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Cash Dividends

On October 25, 2017, our Board approved an increase in our quarterly dividend on our common stock from \$0.050 to \$0.075 per share, effective with respect to dividends payable on December 1, 2017 and later.

For the years ended December 31, 2017 and 2018, our Board declared the following dividends payable on the dates below (in thousands, except per share amounts):

<u>2018</u>	<u>Per Share</u>	<u>Dollar Value</u>
March 1st	\$ 0.075	\$ 1,207
June 1st	\$ 0.075	\$ 1,433
September 1st	\$ 0.075	\$ 1,436
December 1st	\$ 0.075	\$ 1,437
<u>2017</u>	<u>Per Share</u>	<u>Dollar Value</u>
March 1st	\$ 0.050	\$ 833
June 1st	\$ 0.050	\$ 835
September 1st	\$ 0.050	\$ 835
December 1st	\$ 0.075	\$ 1,206

Accumulated other comprehensive income

Our components of Accumulated other comprehensive income are as follows (in thousands):

	<u>Accumulated Other Comprehensive Income</u>
Balance at December 31, 2017	\$ —
Decrease in net unrealized gains associated with available-for-sale securities of the trusts	(17,741)
Reclassification of net unrealized gain activity attributable to the <i>Deferred preneed funeral and cemetery receipts held in trust and Care trusts' corpus</i>	17,741
Balance at December 31, 2018	<u>\$ —</u>

20. SHARE REPURCHASE PROGRAM

On February 25, 2016, our Board approved a share repurchase program authorizing us to purchase up to an aggregate of \$25.0 million of our common stock in accordance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). On October 25, 2017, our Board approved a \$15.0 million increase in its authorization for repurchases of our common stock in addition to the \$25.0 million approved on February 25, 2016, bringing the total authorized repurchase amount to \$40.0 million, in accordance with the Exchange Act.

During the year ended December 31, 2018, we repurchased 1,101,969 shares of common stock for a total cost of \$17.7 million at an average cost of \$16.03 per share pursuant to our share repurchase program. Our shares were purchased in the open market at times and in amounts as management determined appropriate based on factors such as market conditions, legal requirements and other business considerations. Shares purchased pursuant to the repurchase program are currently held as treasury shares. At December 31, 2018, we had approximately \$8.3 million available for repurchase under our share repurchase program.

During the year ended December 31, 2017, we repurchased 574,054 shares of common stock for a total cost of \$14.0 million at an average cost of \$24.35 per share pursuant to our share repurchase program. Our shares were purchased in the open market at times and in amounts as management determined appropriate based on factors such as market conditions, legal requirements and other business considerations. Shares purchased pursuant to the repurchase program are currently held as treasury shares. At December 31, 2017, we had approximately \$26.0 million available for repurchase under our share repurchase program.

On August 18, 2017, we purchased 100,000 shares of our common stock from Melvin C. Payne, our Chairman of the Board and Chief Executive Officer. The purchase of these shares was made pursuant to a privately-negotiated transaction at a price of \$23.85 per share for a total purchase price of \$2.4 million. The purchase price we paid for these shares was the stock's trading price at the time of the transaction. This purchase was not a part of the share repurchase program approved by the Board on February 25, 2016. The repurchase of the shares held by Mr. Payne was approved in advance by our Board, with Mr. Payne abstaining. See Note 26 to our Consolidated Financial Statements included herein for additional information on our related party transactions.

We did not purchase any shares of our common stock during 2016.

21. EARNINGS PER SHARE

Share-based awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are participating securities and included in the computation of both basic and diluted earnings per share. Our grants of restricted stock awards to our employees and directors are considered participating securities and we have prepared our earnings per share calculations to exclude outstanding unvested restricted stock awards, using the two-class method, in the basic and diluted weighted average shares outstanding calculation.

The following table sets forth the computation of the basic and diluted earnings per share for the years ended December 31, 2016, 2017 and 2018 (in thousands, except per share data):

	Year Ended December 31,		
	2016	2017	2018
Numerator for basic and diluted earnings per share:			
Net income	\$ 19,581	\$ 37,193	\$ 11,645
Less: Earnings allocated to unvested restricted stock	(89)	(135)	(57)
Income attributable to common stockholders	<u>\$ 19,492</u>	<u>\$ 37,058</u>	<u>\$ 11,588</u>
Denominator:			
Denominator for basic earnings per common share - weighted average shares outstanding	16,515	16,438	17,971
Effect of dilutive securities:			
Stock options	454	336	66
Convertible subordinated notes	491	941	337
Denominator for diluted earnings per common share - weighted average shares outstanding	<u>17,460</u>	<u>17,715</u>	<u>18,374</u>
Basic earnings per common share	<u>\$ 1.18</u>	<u>\$ 2.25</u>	<u>\$ 0.64</u>
Diluted earnings per common share	<u>\$ 1.12</u>	<u>\$ 2.09</u>	<u>\$ 0.63</u>

The fully diluted weighted average shares outstanding for the years ended December 31, 2016, 2017 and 2018, and the corresponding calculation of fully diluted earnings per share, included 0.5 million, 0.9 million and 0.3 million shares that would have been issued upon the conversion of our convertible subordinated notes as a result of the application of the if-converted method prescribed by the FASB ASC 260.

For the years ended December 31, 2017 and 2018, approximately 354,000 and 1,661,000 stock options were excluded from the computation of diluted earnings per share because the inclusion of such stock options would result in an antidilutive effect. There were no options excluded in the computation of diluted earnings per share for the years ended December 31, 2016.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

22. MAJOR SEGMENTS OF BUSINESS

We conduct funeral and cemetery operations only in the United States. The following table presents revenue, operating income (loss), income (loss) before income taxes, depreciation and amortization, interest expense, income tax expense (benefit), total assets, long-lived assets, capital expenditures and number of operating locations by segment (in thousands, except number of operating locations):

	<u>Funeral</u>	<u>Cemetery</u>	<u>Corporate</u>	<u>Consolidated</u>
Revenue:				
2018	\$ 210,725	\$ 57,267	\$ —	\$ 267,992
2017	200,886	57,253	—	258,139
2016	189,401	58,799	—	248,200
Operating income (loss):				
2018	\$ 60,881	\$ 15,066	\$ (32,640)	\$ 43,307
2017	61,369	15,430	(27,858)	48,941
2016	61,620	18,030	(29,446)	50,204
Income (loss) before income taxes:				
2018	\$ 59,912	\$ 15,349	\$ (56,995)	\$ 18,266
2017	60,634	15,852	(43,704)	32,782
2016	61,163	18,400	(47,322)	32,241
Depreciation and amortization:				
2018	\$ 10,726	\$ 4,891	\$ 1,813	\$ 17,430
2017	9,785	4,589	1,605	15,979
2016	8,891	5,028	1,502	15,421
Interest expense:				
2018	\$ 1,339	\$ —	\$ 19,770	\$ 21,109
2017	1,170	2	11,776	12,948
2016	826	3	10,909	11,738
Income tax expense (benefit):				
2018	\$ 21,717	\$ 5,564	\$ (20,660)	\$ 6,621
2017	(8,159)	(2,133)	5,881	(4,411)
2016	24,019	7,226	(18,585)	12,660
Total assets:				
2018	\$ 686,470	\$ 226,475	\$ 4,557	\$ 917,502
2017	665,483	251,243	4,807	921,533
2016	634,145	241,621	9,303	885,069
Long-lived assets:				
2018	\$ 572,916	\$ 89,654	\$ 1,538	\$ 664,108
2017	537,282	90,292	2,124	629,698
2016	509,361	89,767	2,548	601,676
Capital expenditures:				
2018	\$ 8,296	\$ 3,989	\$ 1,241	\$ 13,526
2017	9,835	5,283	1,277	16,395
2016	17,411	4,962	731	23,104
Number of operating locations at year end:				
2018	182	29	—	211
2017	178	32	—	210
2016	170	32	—	202

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

23. SUPPLEMENTARY DATA

Balance Sheet

The detail of certain balance sheet accounts as of December 31, 2017 and 2018 is as follows (in thousands):

	December 31,	
	2017	2018
Other current assets:		
Federal income tax receivable	\$ —	\$ 923
State income tax receivable	889	422
Other current assets	97	210
Total other current assets	<u>\$ 986</u>	<u>\$ 1,555</u>
Current portion of long-term debt and capital lease obligations		
Term note	\$ 15,000	\$ —
Acquisition debt	1,927	2,015
Capital leases	324	312
Total current portion of long-term debt and capital lease obligations	<u>\$ 17,251</u>	<u>\$ 2,327</u>
Other current liabilities:		
Income taxes payable	\$ 1,120	\$ 962
Deferred rent	241	274
Total other current liabilities	<u>\$ 1,361</u>	<u>\$ 1,236</u>
Accrued liabilities:		
Accrued salaries and wages	\$ 2,643	\$ 4,088
Accrued incentive compensation	6,412	7,395
Accrued vacation	2,417	2,358
Accrued insurance	1,832	3,188
Accrued interest	1,271	1,856
Accrued ad valorem and franchise taxes	1,003	904
Accrued commissions	461	441
Other accrued liabilities	1,520	1,178
Total accrued liabilities	<u>\$ 17,559</u>	<u>\$ 21,408</u>
Other long-term liabilities:		
Deferred rent	\$ 966	\$ 692
Incentive compensation	1,287	1,563
Contingent consideration	1,125	878
Total other long-term liabilities	<u>\$ 3,378</u>	<u>\$ 3,133</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

24. QUARTERLY FINANCIAL DATA (UNAUDITED)

The tables below set forth consolidated operating results by fiscal quarter for the years ended December 31, 2017 and 2018 (in thousands, except earnings per share):

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
2018				
Revenue	\$ 73,387	\$ 63,847	\$ 64,241	\$ 66,517
Gross profit	24,188	16,825	17,114	17,820
Net income (loss)	<u>\$ 9,356</u>	<u>\$ 2,747</u>	<u>\$ 2,200</u>	<u>\$ (2,658)</u>
Basic earnings per common share: (a)	\$ 0.58	\$ 0.15	\$ 0.11	\$ (0.14)
Diluted earnings per common share: (a)	\$ 0.52	\$ 0.15	\$ 0.11	\$ (0.14)
2017				
Revenue	\$ 68,157	\$ 63,852	\$ 61,054	\$ 65,076
Gross profit	23,092	18,667	15,480	19,560
Net income	<u>\$ 7,084</u>	<u>\$ 4,410</u>	<u>\$ 3,038</u>	<u>\$ 22,661</u>
Basic earnings per common share: (a)	\$ 0.42	\$ 0.26	\$ 0.18	\$ 1.41
Diluted earnings per common share: (a)	\$ 0.39	\$ 0.24	\$ 0.17	\$ 1.31

(a) Earnings per share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly per share amounts may not equal the total computed for 2017 and 2018 due to rounding.

25. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

The following information is supplemental disclosure for the Consolidated Statements of Cash Flows (in thousands):

	<u>Year Ended December 31,</u>		
	<u>2016</u>	<u>2017</u>	<u>2018</u>
Cash paid for interest and financing costs	\$ 10,366	\$ 11,092	\$ 18,858
Cash paid for taxes	10,874	5,902	3,543
Fair value of stock, stock options and performance awards issued to directors, officers, and certain other employees	3,275	6,854	6,563

26. RELATED PARTY TRANSACTIONS

On August 18, 2017, we purchased 100,000 shares of our common stock from Melvin C. Payne, our Chairman of the Board and Chief Executive Officer. These shares had been held by Mr. Payne prior to such repurchase for over one year. The purchase of these shares was made pursuant to a privately-negotiated transaction at a price of \$23.85 per share for a total purchase price of \$2.4 million. The purchase price we paid for these shares was the stock's trading price at the time of the transaction. These shares are currently held as treasury shares. This purchase was not a part of the share repurchase program approved by the Board on February 25, 2016. The repurchase of the shares held by Mr. Payne was approved in advance by our Board, with Mr. Payne abstaining.

On December 13, 2017, we purchased real estate totaling \$0.3 million for funeral home expansion projects from an employee at fair market value.

27. SUBSEQUENT EVENTS

On February 20, 2019, we entered into a Fourth Amendment to Second Amended and Restated Employment Agreement (the "Amendment") with Mel Payne, the Company's Chief Executive Officer. The Amendment amends the employment term and annual base salary of Mr. Payne to March 31, 2024 and \$777,000, respectively.

CARRIAGE SERVICES, INC.
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

<u>Description</u>	<u>Balance at beginning of year</u>	<u>Charged to costs and expenses</u>	<u>Deduction</u>	<u>Balance at end of year</u>
Year ended December 31, 2016:				
Allowance for bad debts, current portion	\$ 729	\$ 1,155	\$ 1,138	\$ 746
Allowance for receivables from preneed funeral and cemetery trusts and contract cancellations, non-current portion	\$ 2,042	\$ 943	\$ 819	\$ 2,166
Employee severance accruals	\$ 280	\$ 3,641	\$ 2,404	\$ 1,517
Valuation allowance of the deferred tax asset	\$ 189	\$ 20	\$ —	\$ 209
Year ended December 31, 2017:				
Allowance for bad debts, current portion	\$ 746	\$ 1,248	\$ 1,159	\$ 835
Allowance for receivables from preneed funeral and cemetery trusts and contract cancellations, non-current portion	\$ 2,166	\$ 950	\$ 838	\$ 2,278
Employee severance accruals	\$ 1,517	\$ 571	\$ 2,088	\$ —
Valuation allowance of the deferred tax asset	\$ 209	\$ 35	\$ —	\$ 244
Year ended December 31, 2018:				
Allowance for bad debts, current portion	\$ 835	\$ 1,111	\$ 1,177	\$ 769
Allowance for receivables from preneed funeral and cemetery trusts and contract cancellations, non-current portion	\$ 2,278	\$ 730	\$ 857	\$ 2,151
Employee severance accruals	\$ —	\$ 1,649	\$ 508	\$ 1,141
Valuation allowance of the deferred tax asset	\$ 244	\$ 32	\$ —	\$ 276

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

ITEM 9A. CONTROLS AND PROCEDURES.

Management's Evaluation of Disclosure Controls and Procedures

Our management, including our principal executive and financial officers, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act) as of the end of the period covered by this Form 10-K. Our disclosure controls and procedures are designed to ensure that the information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and to ensure that such information is accumulated and communicated to management, including our principal executive and financial officers, as appropriate, to allow timely decisions regarding required disclosure. Based on such evaluation, our principal executive and financial officers have concluded that our disclosure controls and procedures were effective as of December 31, 2018 (the end of the period covered by this Annual Report on Form 10-K).

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Management's report on our internal control over financial reporting is presented on the following page of this Form 10-K. Grant Thornton LLP, the independent registered public accounting firm that audited the financial statements included in this Form 10-K, has issued an attestation report on our internal control over financial reporting.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined under Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934, as amended.

Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's Consolidated Financial Statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

- (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the U.S., and that our receipts and expenditures are being made only in accordance with authorizations of management and our directors; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our Consolidated Financial Statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management conducted an assessment of the Company's internal control over financial reporting as of December 31, 2018 using the framework specified in *Internal Control — Integrated Framework (2013)*, published by the Committee of Sponsoring Organizations of the Treadway Commission. Based on such assessment, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2018.

The Company's internal control over financial reporting as of December 31, 2018 has been audited by Grant Thornton LLP, an independent registered public accounting firm, which also audited the financial statements of the Company for the year ended December 31, 2018, as stated in their report which is presented in this Annual Report.

/s/ Melvin C. Payne

Melvin C. Payne

Chief Executive Officer and Chairman of the Board

/s/ Viki K. Blinderman

Viki K. Blinderman

Senior Vice President, Principal Financial Officer and Secretary

February 28, 2019

Changes in Internal Control Over Financial Reporting

During the three months ended December 31, 2018, there was no change in our system of internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION.

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

Code of Ethics

We have adopted a Business Ethics and Code of Conduct (the “Code”), which is applicable to our principal executive officer and other senior financial officers, who include our principal financial officer, principal accounting officer or controller, and persons performing similar functions. The Code is available on our internet website at www.carriageservices.com. To the extent required by SEC rules, we intend to disclose any amendments to this code and any waiver of a provision of the Code for the benefit of our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, on our website within four business days following any such amendment of waiver, or within any other period that may be required under SEC rules from time to time.

The information required by Item 10 is incorporated by reference to the registrant’s definitive proxy statement relating to its 2019 annual meeting of stockholders, which proxy statement will be filed pursuant to Regulation 14A of the Exchange Act within 120 days after the end of the last fiscal year.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by Item 11 is incorporated by reference to the registrant’s definitive proxy statement relating to its 2019 annual meeting of stockholders, which proxy statement will be filed pursuant to Regulation 14A of the Exchange Act within 120 days after the end of the last fiscal year.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The information required by Item 12 is incorporated by reference to the registrant’s definitive proxy statement relating to its 2019 annual meeting of stockholders, which proxy statement will be filed pursuant to Regulation 14A of the Exchange Act within 120 days after the end of the last fiscal year.

The following table, required by Item 201(d) of Regulation S-K, summarizes information regarding the number of shares of our common stock that are available for issuance under all of our existing equity compensation plans as of December 31, 2018.

<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights</u> (a)	<u>Weighted-average exercise price of outstanding options, warrants and rights</u> (b)	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</u> (c)
Equity compensation plans approved by security holders	1,523,130	\$ 21.95	2,075,073
Equity compensation plans not approved by security holders	—	—	—
Total	<u>1,523,130</u>	<u>\$ 21.95</u>	<u>2,075,073</u>

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.

The information required by Item 13 is incorporated by reference to the registrant’s definitive proxy statement relating to its 2019 annual meeting of stockholders, which proxy statement will be filed pursuant to Regulation 14A of the Exchange Act within 120 days after the end of the last fiscal year.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by Item 14 is incorporated by reference to the registrant's definitive proxy statement relating to its 2019 annual meeting of stockholders, which proxy statement will be filed pursuant to Regulation 14A of the Exchange Act within 120 days after the end of the last fiscal year.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(1) FINANCIAL STATEMENTS

The following financial statements and the Report of Independent Registered Public Accounting Firm are filed as a part of this Form 10-K on the pages indicated:

	<u>Page</u>
Reports of Independent Registered Public Accounting Firm	51
Consolidated Balance Sheet as of December 31, 2017 and 2018	53
Consolidated Statements of Operations for the Years Ended December 31, 2016, 2017 and 2018	54
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2016, 2017 and 2018	55
Consolidated Statements of Cash Flows for the Years Ended December 31, 2016, 2017 and 2018	56
Notes to Consolidated Financial Statements	57
Management's Report on Internal Control over Financial Reporting	107

(2) FINANCIAL STATEMENT SCHEDULES

The following Financial Statement Schedule is included in this Form 10-K on the page indicated:

	<u>Page</u>
Financial Statement Schedule II — Valuation and Qualifying Accounts	105

All other schedules are omitted as the required information is inapplicable or the information is presented in the Consolidated Financial Statements or related notes.

(3) EXHIBITS

A copy of this Form 10-K, excluding exhibits, will be furnished at no charge to each person to whom a proxy statement for our 2019 annual meeting of stockholders is delivered upon the request of such person. Exhibits to this Form 10-K are available upon payment of a reasonable fee, which is limited to our expenses in furnishing the requested exhibit. Requests for copies should be directed to our Corporate Secretary, by mail at 3040 Post Oak Boulevard, Suite 300, Houston, Texas 77056 or by phone at 1-866-332-8400 or 713-332-8400.

<u>Exhibit No.</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation, as amended, of the Company. Incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 1996.
3.2	Certificate of Amendment dated May 7, 1997. Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for its fiscal quarter ended September 30, 1997.
3.3	Certificate of Amendment dated May 7, 2002. Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for its fiscal quarter ended June 30, 2002.
3.4	Amended and Restated Bylaws of the Company. Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1/A (File No. 333-05545) filed on July 18, 1996.
3.5	Amendments to the Bylaws of the Company effective December 18, 2000. Incorporated by reference to Exhibit 3.8 to the Company's Annual Report on Form 10-K for its year ended December 31, 2000.

- 3.6 Amendments to the Bylaws of the Company effective May 20, 2008. Incorporated by reference to Exhibit to the Company's current report on Form 8-K filed May 28, 2008.
- 4.1 Indenture, dated as of March 19, 2014, by and among Carriage Services, Inc. and Wilmington Trust, National Association, as Trustee. Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed March 19, 2014.
- 4.2 Indenture, dated as of May 31, 2018, among the Company, the Guarantors and Wilmington Trust, National Association, as Trustee. Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on May 31, 2018.
- 4.3 Form of 6.625% Senior Notes due 2026. Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on May 31, 2018.
- 4.4 Second Amended and Restated 2006 Long-Term Incentive Plan. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2012. †
- 4.5 First Amendment to Carriage Services, Inc. Second Amended and Restated 2006 Long-Term Incentive Plan. Incorporated by reference to Exhibit 10.28 to the Company's Annual Report on Form 10-K filed March 5, 2014. †
- 4.6 Amended and Restated Carriage Services, Inc. 2007 Employee Stock Purchase Plan. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended September 30, 2013. †
- 4.7 Amended and Restated Carriage Services, Inc. 2007 Employee Stock Purchase Plan (incorporated by reference to Appendix A to the Company's Definitive Proxy Statement on Schedule 14A filed on April 4, 2018).
- 4.8 First Amendment to the Amended and Restated Carriage Services, Inc. 2007 Employee Stock Purchase Plan (incorporated by reference to Appendix B to the Company's Definitive Proxy Statement on Schedule 14A filed on April 4, 2018).
- 4.9 Carriage Services, Inc. 2017 Omnibus Incentive Plan. Incorporated by reference to Appendix A of the Proxy Statement on Schedule 14A filed on April 5, 2017. †
- 10.1 Credit Agreement dated August 30, 2012, among Carriage Services, Inc. as the Borrower, and Bank of America, N.A. as the Administrative Agent and Sole Lender. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed September 4, 2012.
- 10.2 First Amendment to Credit Agreement dated November 29, 2012, among Carriage Services, Inc. as the Borrower, and Bank of American N.A. as the Administrative Agent and Sole Lender. Incorporated by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2012.
- 10.3 Second Amendment to Credit Agreement dated February 14, 2013, among Carriage Services, Inc. as the Borrower, and Bank of America, N.A. as the Administrative Agent and Sole Lender. Incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2012.
- 10.4 Third Amendment and Commitment Increase dated April 23, 2013 among Carriage Services, Inc., the Lenders and Bank of America, N.A. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed April 25, 2013.
- 10.5 Fourth Amendment to Credit Agreement, dated as of February 27, 2014, by and among Carriage Services, Inc., the banks listed on the signature page thereto and Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 5, 2014.
- 10.6 Fifth Amendment to Credit Agreement, dated as of April 14, 2014, by and among Carriage Services, Inc., the banks listed on the signature page thereto and Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 16, 2014.

- 10.7 Sixth Amendment to Credit Agreement, dated May 20, 2015, by and among the Company, Bank of America, N.A., as Administrative Agent, and the other lenders party thereto. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 22, 2015.
- 10.8 Seventh Amendment to Credit Agreement, dated February 9, 2016, by and among the Company, Bank of America, N.A., as Administrative Agent, and the other lenders party thereto. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 9, 2016.
- 10.9 Eighth Amendment and Commitment Increase to Credit Agreement, dated April 25, 2018, by and among the Company, Bank of America, N.A., as Administrative Agent, and the other lenders party thereto. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 27, 2018.
- 10.10 Credit Agreement, dated May 31, 2018, among the Company, the financial institutions party thereto, as lenders and Bank of America, N.A., as Administrative Agent. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 31, 2018.
- 10.11 First Amendment to Credit Agreement dated as of November 8, 2018, among Carriage Services, Inc., the financial institutions party thereto, as lenders, and Bank of America, N.A., as administrative agent. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 9, 2018.
- 10.12 Second Amended and Restated Employment Agreement dated March 14, 2012 between Carriage Services, Inc. and Melvin C. Payne. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 20, 2012. †
- 10.13 First Amendment to Second Amended and Restated Employment Agreement by and between Carriage Services, Inc. and Melvin C. Payne dated March 3, 2014. Incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for its quarter ended March 31, 2014. †
- 10.14 Indemnity Agreement with Melvin C. Payne dated December 18, 2000. Incorporated by reference to Exhibit 10.20 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2000. †
- 10.15 Employment Agreement with Mark R. Bruce dated January 4, 2011. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended March 31, 2013. †
- 10.16 Employment Letter with Mark R. Bruce dated March 14, 2012. Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for its quarter ended March 31, 2013. †
- 10.17 Employment Agreement with Shawn R. Phillips dated January 4, 2011. Incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for its quarter ended March 31, 2013. †
- 10.18 Employment Letter with Shawn R. Phillips dated March 14, 2012. Incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for its quarter ended March 31, 2013. †
- 10.19 Employment Agreement with Paul D. Elliott dated August 31, 2012. Incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q dated March 31, 2013. †
- 10.20 Form of Employee Performance-Based Stock Award Agreement. Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed August 7, 2012. †
- 10.21 Form of Director Performance-Based Stock Award Agreement. Incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2012. †
- 10.22 Director Compensation Policy dated March 5, 2012. Incorporated by reference to Exhibit 10.24 to Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2011. †
- 10.23 Incentive Stock Option Agreement Under Carriage Services, Inc. Second Amended and Restated 2006 Long-Term Incentive Plan. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2013. †

- 10.24 Restricted Stock Agreement Under Carriage Services, Inc. Second and Amended and Restated 2006 Long-Term Incentive Plan. Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2013. †
- 10.25 Form of Employee Performance Award Agreement. Incorporated by reference to Exhibit 10.24 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2015. †
- 10.26 Retirement and Release Agreement dated effective September 30, 2016 between Carriage Services, Inc. and David J. DeCarlo. Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on October 3, 2016. †
- 10.27 Second Amendment to the Second Amended and Restated Employment Agreement by and between Carriage Services, Inc. and Melvin C. Payne, dated effective as of March 21, 2017. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 23, 2017. †
- 10.28 Third Amendment to the Second Amended and Restated Employment Agreement by and between Carriage Services, Inc. and Melvin C. Payne, dated effective as of May 12, 2017. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed May 12, 2017. †
- 10.29 Fourth Amendment to the Second Amended and Restated Employment Agreement by and between Carriage Services, Inc. and Melvin C. Payne, dated effective as of February 20, 2019. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed February 26, 2019. †
- 10.30 Form of Employee Restricted Stock Agreement under Carriage Services, Inc. 2017 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.30 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2017. †
- 10.31 Form of Employee Incentive Stock Option Agreement under Carriage Services, Inc. 2017 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.31 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2017. †
- 10.32 Form of Employee Performance Share Unit Award Agreement under Carriage Services, Inc. 2017 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.32 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2017. †
- 10.33 Form of Employee Stock Option Agreement under Carriage Services, Inc. 2017 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.33 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2017. †
- 10.34 Form of Exchange Agreement. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 3, 2018.
- 10.35 Form of Notes Repurchase Agreement. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 21, 2018.
- 10.36 Release and Separation Agreement by and between Carriage Services, Inc. and Mark R. Bruce, dated effective November 1, 2018.* †
- 10.37 Form of Performance Award Agreement under Carriage Services, Inc. 2017 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on February 26, 2019. †
- *21.1 Subsidiaries of the Company.
- *23.1 Consent of Grant Thornton LLP.
- *31.1 Certification of Periodic Financial Reports by Melvin C. Payne in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002.

- *31.2 Certification of Periodic Financial Reports by Viki K. Blinderman in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002.
- **32 Certification of Periodic Financial Reports by Melvin C. Payne and Viki K. Blinderman in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002 and 18 U.S.C. Section 1350.
- *101 Interactive Data Files.

(*) Filed herewith.

(**) Furnished herewith.

(†) Management contract or compensatory plan or arrangement.

ITEM 16. FORM 10-K SUMMARY.

None.

CORPORATE INFORMATION

Carriage Services is a leading provider of funeral and cemetery services and merchandise in the United States. As of December 31, 2018, Carriage operated 182 funeral homes in 29 states and 29 cemeteries in 11 states.

BOARD OF DIRECTORS

Melvin C. Payne

Chief Executive Officer and
Chairman of the Board

Bryan D. Leibman

President and Chief Executive Officer,
Frosch Travel

Barry K. Fingerhut

Chief Executive Officer,
Certification Partners, LLC

Donald D. Patteson, Jr.

Investor

James R. Schenck

President and Chief Executive Officer,
PenFed Credit Union

Douglas B. Meehan

Deputy Chief Investment Officer,
van Biema Value Partners, LLC

ADVISOR TO THE BOARD OF DIRECTORS

Gregory R. Brudnicki

Mayor of Panama City, FL

EXECUTIVE TEAM

Melvin C. Payne

Chief Executive Officer and
Chairman of the Board

Viki K. Blinderman

Senior Vice President, Principal Financial Officer,
Chief Accounting Officer and Secretary

C. Benjamin Brink

Senior Vice President, Chief Financial Officer
and Treasurer

Steven D. Metzger

Senior Vice President and General Counsel

Shawn R. Phillips

Senior Vice President and Head of Strategic
and Corporate Development

Michael S. Loeffel

Vice President of Human Resources

Independent Public Accountants

Grant Thornton LLP, Houston, Texas

Form 10-K Availability

The Company's Annual Report on Form 10-K for the year ended December 31, 2018 may be obtained by writing to: Investor Relations, Carriage Services, Inc., 3040 Post Oak Boulevard, Suite 300, Houston, Texas 77056; via the Company's website: www.carriageservices.com; or via the SEC's website: www.sec.gov.

Common Stock

Carriage Services, Inc.'s common stock is traded on the New York Stock Exchange under the symbol "CSV".

Transfer Agent & Registrar

American Stock Transfer & Trust Company, LLC
6201 15th Avenue
Brooklyn, New York 11219
800.937.5449
www.amstock.com

Houston Support Office

Carriage Services, Inc.
3040 Post Oak Boulevard, Suite 300
Houston, Texas 77056
713.332.8400
www.carriageservices.com

Forward-looking Statements

Statements made in this Annual Report that are not historical facts are intended to be forward-looking statements within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are based on assumptions that the Company believes are reasonable; however, many important factors, including factors not in our control, or as discussed under "Forward-Looking Statements" in Company's Form 10-K for the year ended December 31, 2018, could cause the Company's results to differ materially from the forward-looking statements made herein and in any other documents or presentations made by or on behalf of the Company.





CARRIAGE SERVICES, INC.

3040 Post Oak Boulevard, Suite 300
Houston, Texas 77056

713.332.8400

www.carriageservices.com