CARRIAGE SERVICES, INC.

Moderator: (Chris Jones)
August 6, 2014
10:00 a.m. ET

Operator: Good day, ladies and gentlemen, and welcome to the Carriage Services Second Quarter Earnings Conference Call and Webcast. At this time, all participants are in a listen only mode. Later, we will conduct a question and answer session and instructions will be given at that time. If anyone should require operator assistance, please press star and then zero on your touch-tone telephone. As a reminder, this conference call is being recorded.

I'd now introduce your host for today's conference, (Chris Jones) representing Carriage Services. You may begin.

(Chris Jones): Thank you, and good morning, everyone. We're glad you could join us. We'd like to welcome you to the Carriage Services conference call. Today, we will be discussing the company's 2014 second quarter results, which were released yesterday after the market closed.

Carriage Services has posted a press release, including supplemental financial tables and information on its website at carriageservices.com. This audio conference is being recorded and an archive will be made available on Carriage's website.

Additionally, later today, a telephone replay of this call will be made available and active through August 8. Replay information for the call can be found on a press release distributed yesterday.

Speaking on the call today from management are Mel Payne, Chairman and Chief Executive Officer; and Bill Heiligbrodt, Executive Vice Chairman. Today's call will begin with formal remarks from management followed by a question-and-answer period.

Please note that during the call, management will make forward-looking statements in accordance with the Safe Harbor provision of the Private Securities Litigation Reform Act of 1995. I'd like to call your attention to the risks associated with the statements, which are more fully described in the company's report filed on Form 10-Q and other filings with the Securities and Exchange Commission.

Forward-looking statements, assumptions or factors stated or referred to on this conference call are based on information available to Carriage Services as of today. Carriage Services expressly disclaims any duty to provide updates to these forward-looking statements, assumptions or other factors after the date of this call to reflect the occurrence of events, circumstances or changes in expectations.

In addition, during the course of this morning's call, management will reference certain non-GAAP financial performance measures. Management's opinion regarding the usefulness of such measures, together with the reconciliation of such measures to the most directly comparable GAAP measures, or historical periods, are included in the press release and the company's filings with the Securities and Exchange Commission.

Now I'd like to turn the call over to Mel Payne, Chairman and Chief Executive Officer.

Melvin Payne: Thank you, (Chris). Before I get into the quarter performance, I want to mention just a few things about the organizational structure. In early March, as part of our dynamic change over time, we reorganized the company again, second time in little over two years. Dave DeCarlo joined the company full time from being our Lead Director and Chairman of the Compensation Committee.

The three of us, Bill, Dave and myself, now operate as executive – as the executive team. We view ourselves as the executive partners. The whole framework of the company is built around a partnership structure at the regional level and at the individual business level. So we comprise the executive team, and today we have Dave DeCarlo available on the call as well.

Dave is focused on corporate development, the acquisition landscape, so if there are any questions at the end of Bill and I's presentation, feel free to ask him.

We had a great second quarter, but the three of us view it as a down payment on what's about to come. And I'm going to turn the call over to Bill to get into more explanation of that.

L. William Heiligbrodt: OK, thank you, Mel. There's a lot of detail for you in this second quarter report in our press release, but I would like to focus first on earnings per share and our performance margins.

Adjusted diluted earnings per share for the second quarter up $0.32 per share represented a growth of 28 percent versus 2013. Total field EBITDA margins at the same time moved back towards 40 percent. This allowed our year-to-date earnings per share to be $0.63 per share, again, back double digit at 12.5 percent growth for the six months with fuel margins over 40 percent.

Next let's look at same-store comparisons. We mentioned in our first quarter report that we were comparing against very high and unusual numbers in the first quarter of 2013. And we were actually down 6.5 percent. Again, we said, funeral cycles tend to run in periods longer than 90 days, and we expected those numbers to even out as we move through the next three quarters of 2014.

Well, that has certainly been the case. Second quarter same-store volumes were down 1.5 percent, a big improvement over the first quarter and we were actually back positive towards the end of the quarter.

Now let's focus on the future, looking at the remainder of 2014. I'm going to cover eight main points with you today. The first point, we should continue to see better comparisons in same-store volumes in the third and fourth quarter of 2014.

Second, during the second quarter of 2014, we replaced $90 million of junior subordinated securities that carried a 7 percent interest rate, with the new 7-year convertible subordinated note of $143.8 million at 2.75 percent. Even with the size differential between the two issues, it still represents the $2,350,000 interest saving to Carriage on an annual basis. We completed this financing mid-April of the second quarter. Therefore, we are expecting $0.13 per share benefit on an annual basis from this refinancing, and approximately $0.09 per share should occur during 2014.

Third point. Also in the second quarter, we negotiated and completed a new bank credit, increasing from $242 million to $325 million, with the new maturity of five years. This leaves us with $150 million of available bank credit plus our free cash flow to finance the continuing acquisition and growth investment program for our shareholders. This was all accomplished with no increase in the cost of financing to Carriage. In fact, this credit bears a floating rate that currently is slightly under 3 percent.

Fourth point. Also in May of the second quarter, we completed the purchase of 6 businesses from Service Corporation International for over $50 million, a very large transaction and integration for Carriage. Since 2011, looking at our previously completed acquisitions, this represents more like what was completed on an annual basis and represents over six months of what I call heavy lifting by our staff at Carriage. The early results for these acquisitions looks very good and appear to be exceeding our expectation. It looks like we have a good chance for these acquisitions to slightly exceed $0.11 per share accretion for 2014 alone.

Fifth point. The third quarter will be the first quarter to receive the full benefit of both the financing and the new acquisitions rather than the partial second quarter for both.

Sixth, all the responsibility – all the responsible members of the management at Carriage are reviewing all our overhead expense numbers to be certain there is value added in all these expenses. The results of that work showed slight improvement in the second quarter, which should be more meaningful throughout the remainder of 2014.

Seventh point. For the six months of 2014, our previously reported adjusted diluted earnings per share were $0.63, an increase of 12.5 percent. Also, repeating, we were up 28 percent at $0.32 in the second quarter earnings per share versus 2013. Comparisons continue to appear easier as we move through 2014. Actual third quarter earnings per share for 2013 were $0.16 per share and the fourth quarter was $0.26 per share. Therefore, we will be comparing against $0.42 per share for the remainder of this year.

Eighth and finally, with the balance sheet improvements we have accomplished since 2012, including two debt replacements plus a new very competitive bank financing that has now been revised two times, we have significantly reduced our cost of capital. Today, we believe the cost of capital is slightly under 8.5 percent. In my personal opinion, this leaves Carriage in an extremely competitive position for a company our size, allowing us to be very competitive on all future investments, as well as provide a very good return for our shareholders on those investments.

So these eight important points, facts and benefits had prompted us to increase our rolling four quarters outlook in the June 30, 2015, to a range of $1.42 to $1.48. There's a lot more detailed information available to you in our press release and trend statements. We always stand ready to clarify any of this information if needed. Let us hear from you if you have questions.

In closing, all of us at Carriage think our future is very bright, and we look forward to reporting our results to you as we move through the remainder of 2014.

Melvin Payne: Thank you, Bill. I will summarize a few more things that I think would be very important to investors. In the 2013 annual shareholder letter, if you haven't read it, I really encourage you to go back and read it, because even though it's a lot of words and we mostly talk about the high performance culture, framework of Carriage, I also mentioned that this culture and high performance framework and leadership drives high and sustainable quantitative results. And when we started off at the end of '11 with the new beginning starting in '12, we put a five-year timeframe on going from good to great. Now these are words, people say they're words. They're not just words within the company, and I want to get this point across.

We're halfway through our defined five-year timeframe. That has nothing to do with us becoming a great company by the end of 2016. Because by the time we get close to that, we will redefine what greatness means and raise the bar across the company in terms of high-end sustainable quantitative performance.

Now we recently had a midyear review with all of our managing partners and sales managers from every business across America, late May, all our support team leaders and many of the staff along with our senior leaders. We have never had a meeting like this. Our people left inspired, challenged to go back to their businesses and act on any weakness that they find in their business.

We faced two primarily over the last year, cremation averages and the revenue-related to it and preneed property sales in our cemeteries. So they are all over it. Our company is all over it. Everyone is aligned. We’ve never had talent this deep and this broad. And we saw instant improvement, starting in June, on our cremation averages that has continued into July.

And if you put together what Bill said, better volume comparisons in the second half along with better average on each unit volume, then you've got the operating leverage that is so inherent in this business kicking in for you and giving you a boost.

Along with that, we have, over the last year and especially over the last six months, been accumulating large, unrealized gains on our trust funds. We began to harvest those gains recently. That doesn't mean they will all show up as recognized revenue, but they're real. And we're harvesting them, and they will show up and be meaningful over the next year or two.

And finally, the acquisition landscape is really favorable right now for our company and is getting a lot of attention. We're going to a lot of conferences. We're really getting the word out. And I think the company has never been better positioned.

In terms of the new acquisitions that we made, I can't express how excited I am, and I know I speak for Bill, Dave and our other team members, at how much dynamic change has happened in these businesses and in these markets in a short amount of time.

It's been unbelievable to see the talent that has come over to these businesses that has a following in the markets, and it's a wonderful thing to see. So I think the underwriting of those businesses will turn out to be conservative, as we look a year or two, three out.

And finally, I want to end this call, like in most calls, with our second quarter performance heroes from each region.

East region. Deana Kelly, North Brevard Funeral Home, Titusville, Florida; Frank Forastiere, Forastiere Funeral Home, Springfield, Massachusetts; John Fitzpatrick, Donahue-Cecere Funeral Homes, Westbury, New York, that's long Island; Michael Redgate, Redgate-Hennessy Funeral Directors, Trumbull, Connecticut; Curtis Ottinger, Heritage Funeral Home, Chattanooga, Tennessee, they joined us in November of '13; Ben Friberg, Heritage Funeral Homes, Fort Oglethorpe, Georgia, also at the same time in November '13.

The West region – Michael Nicosia, Ouimet Bros. Concord Funeral Chapel, Concord, California; Richard Munoz, Connolly & Taylor, Martinez, California; Verdo Werre, McNary-Moore Funeral Service, Colusa, California; Terry Shotkoski, Cloverdale Funeral Home, Boise, Idaho.

And in the Central region – Pam Parramore, Baker-Stevens-Parremore Funeral Home, Middletown Ohio; Jeff Hardwick, Bryan & Snyder Funeral Home, Zanesville, Ohio; Mark Cooper, Seaside Funeral Home, Corpus

Christi, Texas; last but not least Randy Valentine, Dieterle Memorial Home, Montgomery, Illinois.

When we call these people performance heroes, we actually mean it. Their performance in the second quarter was extraordinary, and they will continue to achieve those kind of high standard achievements, which has a high financial performance following, like night follows day, for the rest of the year. They will also be joined, I'm sure, by others, which we will call out in future quarters.

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

Operator: Thank you. Ladies and gentlemen, if you have a question at this time, please hit star and then one on your touch-tone telephone. If your question has been answered or if you wish to remove yourself from the queue, please hit the pound key.

Our first question comes from Joe Janssen of Barrington. Your line is open.

Joseph Janssen: I came on the call late. I think when Bill was kind of at the tail end of his list, so I apologize if you addressed some of this questions, but maybe let me start with the interest expense and the timing. We know you did the debt refi, you had some amendments to the credit facility. The Q2 interest expense, is that kind of the quarterly run rate? Or should I expect that just because of timing here to sequentially improve here in Q3 before it gets to a full run rate?

L. William Heiligbrodt: Joe, the interest differential, we're expecting will get slightly better. We're expecting on an annual basis, $0.13 per share from the refinancing, even though the new issue was some 50-plus million higher than what we replaced, about $0.11 of that should flow through during 2014.

Joseph Janssen: OK. And then, I heard Mel's comments there towards the tail end regarding the acquisition pipeline, probably being the strongest – maybe strongest ever. I know you guys have consumed six properties with SCI. That's taken a considerable amount of effort via the team. Just kind of expectations in the back half of the year. Do we expect some activity will pick up maybe Q3, Q4 in terms of announcing some (letter) of intents or some acquisitions?

Melvin Payne: Yes. We do expect to do something between now and year end, but we don't want to get granular on when that might happen. We're looking at some very high quality opportunities right now, but we're very selective. The integration of these businesses went very well and mostly it happened quickly because we did so much work before the closing. So I don't think that's taking a lot of our time right now. So we're back out in the market and talking to a lot of people.

L. William Heiligbrodt: I want to mention though again, and I did mention it, it's one of my points, that six actual funeral businesses and one cemetery, based on historical situations here, certainly since I've been here, it represents almost a year of work. So the fact – we're pretty proud of the fact that we accomplished that correctly, integrated it correctly. And we're expecting that acquisition on an annual basis possibly to generate as much as $0.22 per share.

So when I mentioned that $0.11 for '14, that's really for half of the year because it took us about 15 to 30 days to get everything really up and running properly. So we really only operated this business as far as our EPS the way I look at it for one month, so far. So I think this is going to be very advantageous to us, and it's a very large transaction.

Melvin Payne: I would – just a little more flavor on the future though. We're very focused on large strategic markets and rebuilding a target list of very high quality independence in, let's say, six to eight major strategic markets that are large metropolitan areas where there are a number of high quality targets. And we're profiling, we're building relationships, looking at motivations and timing.

To do it this way, it takes a little more time. But the result is – will be phenomenal. And it's hard to say on a quarterly basis how that falls. But I – looking at one year or two, I have no doubt that we want to hit the annualized revenue that Bill talks to people about. I think that's a pretty low bar and given the landscape and the choices out there from these high-quality businesses to have a succession plan like us, I think we're in a wonderful spot over the next five years. But over the next two, you're going to see some meaningful activity.

Joseph Janssen: Right. I guess the way we look at it here is, I mean, the SCI transaction was essentially the total volume for the entire year, and you're now building obviously the pipe for 2015.

Melvin Payne: Yes, and I went through that in the '90s, and it wasn't a good experience where we budgeted acquisitions. So I'm not real keen on that, and I know it's hard to build models without doing it, but you're going to find me looking out and saying, we're going to have a goal of doing a lot, and that's a minimum, what you're talking about. I just can't tell you which quarter it's going to be, and I don't want to get on that treadmill.

Joseph Janssen: OK. And then the competitive dynamics out there, the competitive landscape, you guys kind of talked about you're at an advantage given your low cost of debt or low cost to finance the acquisitions on a go forward basis.

L. William Heiligbrodt: Actually, totally – total capital, total cost to capital.

Joseph Janssen: Are you – is there anyone else out there that you're aware of that has that advantage or even considerable rate? Or I mean, are you the only person in town that has those rights?

L. William Heiligbrodt: I can't speak for everyone else. All I can speak for is our ourselves. I've been obviously a banker and an executive in a major bank and looked at these kind of numbers most of my business career, and you just don't see this kind of number with companies our size structured as well as we have it structured. So I'm very, very happy that we have that kind of situation going forward. So that when we do make an acquisition, we realize it fully for both the company and our shareholders.

Melvin Payne: Yes, and my comment on that might – is a little different than the gist of your question. I don't view it as a competitive advantage. I view it as a wonderful thing for our shareholders, but it's not a competitive advantage on acquisitions. The competitive advantage on acquisitions is the nature of the company, the framework, the culture, the models that we use and the legacy of what we can do and maintain with a local high-value personal service business. That's the competitive advantage.

The fact – this is not going to cause – it's not going to cause us to pay more for any business to get a business. They're going to join us because we're they're choice. And they're going to join us at a price that is a good price for a good business, but the cost of capital is going to accrue to the benefit of the shareholders, of which I'm a very large one.

Joseph Janssen: I appreciate you guys taking my questions and good quarter.

Operator: Thank you. Again, ladies and gentlemen, if you have a question, please hit star and then one.

Our next question comes from Jamie Clement of Sidoti. Your line is open.

James Clement: Mel, Bill, Dave, good morning. Mel, I wanted to – and actually Bill, Dave you all have, I mean, you all have infinitely more experience in this industry than I do. And Mel, you touched on some of these points. My question is not about the next six months, my question is not about the next 12 months, but as you look at it this wave of consolidation, there's certainly going to be some potential with the shareholders out there that remember the 1990s and you referred to the treadmill that you don't want to get on, and obviously I think that's a good thing. Can you talk about some of the distinct differences that you see between this go around of consolidation versus the 1990s? Obviously, Carriage Services is in much better physical shape and financial shape than it was. I think your friends down the road in Houston are also in much better shape than they were, but can you talk about maybe some demographic issues, maybe some sellers or sort of more of that preneed buying stage, if you will, of their careers? Just answer the question however you like.

L. William Heiligbrodt: Well, you asked about three questions there at once. I'm going to – this is Bill. I'm going to address acquisitions. Number one, not all acquisitions in the '90s were bad. Let's put it that way first, OK. Number two, Mel and I had an agreement, when I joined the company and when we set out on this journey that he mentioned in 2011, that we were going to be totally open with shareholders on our numbers, on how we did the acquisitions. I think there's many on this call that have seen what we're doing and how we're doing it. And we would – we're an open book.

Before I walked in this meeting, Mel had a list of the acquisitions that we have completed since 2011 and how well they have performed on our operating standards model. While he's making a trip, I'm going to go back and recalculate the return on investment on those acquisitions. But we have, in every single one of those acquisitions, been open with the shareholders if they were interested. And we've also been open with what the returns are, and we've gone back and showed them what the results were of those acquisitions.

Because I do think there's ways to do this thing right. I do think that there's a definite need for consolidation in this industry. I think it's a worthwhile endeavor. I think that we run these businesses quite well. That's why I'm here at this company. I like it. I like what we do, and I like how we do it. And I'm not concerned at all – in fact, I'd be willing to write papers on it for the universities, I feel so strongly about it.

In fact, I'm doing some of that, especially on the acquisition side because how well we can do this, taken into account how we do it and how we match up the acquisitions with our operating models, which was a whole basis of Mel and I starting what we've done here as far as acquisitions are concerned. We first look for businesses that are already capable of operating within our system and provide a high standard of performance that Mel wants to have in this company.

So your question to me is kind of almost second phase. We're past that. We know how to do this and I look at this as a big opportunity for our shareholders. The returns are fantastic, it's a fantastic industry. It's not given to a great deal of change, it's highly predictable. And if you can't operate in that, then I almost feel like you shouldn't be in business (inaudible).

Melvin Payne: I'll give you a really good data point. In the '90s, before we went public, we had a guy invest in the company, pre-public, his name was Barry Fingerhut. He was a big investor in all the death care companies in that period of time. Money manager out of New York, sold his company around '98 or so, '99, and then he was on our board, so he had to get off about the time the industry crashed.

So we had a board meeting yesterday, and we were going over some of these things Bill just mentioned. And just how different we are doing what we do now compared to when he was witnessing it in the '90s. And after the board meeting, he came into my office and he said, "Mel, the only thing similar now versus when I was on the board before is the name of the company and you're the CEO. Everything else is completely radically different." And he wanted us to try to get it to be a case study at some university.

I said, “Look, we're too busy creating value to worry about case studies on this company,” but it is very unusual, and it works because the people in the field respond to it. They're inspired by it. We got businesses that you wouldn't think that could produce the kind of performance they do and sustain it. But it's because it's broad, it's deep, and the alignment has never been the way it is today.

And it's a fun thing to come to work here and see how this works. If you ever want to come down and look beneath the covers, because I can tell you, you will not be able to figure it out in New York. You will have to come down and look at how it works here underneath the covers, because it's not just Bill and Dave and I. I mean, this thing is greased.

To give you an example, we started the new beginning at the beginning of '12. We had a big major reorganization, but beginning at this year, we began to look hard at all the departments. And you mentioned before overhead got high, we thought where we're going to do a lot more, we had a big win, but this is how it works.

Since the beginning of the year, really, maybe a little further back, we've had a new head of accounting and huge change within the accounting department to get better, slim down, get more productive, more energy, more cross-department collaboration, same thing in HR. We've got a new leader in HR, same thing. Now we're getting more work done at a higher quality with fewer people and better leadership. Same thing in IT, same thing in corporate development, and now about – have the same thing in legal.

So it's never good enough in a company like this. And so we're going to have more talent, fewer headcounts and less overhead producing better work. And you layer on these acquisitions and the same-store performance and then the trust funds, it gets very exciting looking out.

James Clement: Thank you all so much for your time, I appreciate it.

Operator: Thank you. I'm not showing any further questions in queue. I'd like to turn the call back over to management for any further remarks.

Melvin Payne: Thank you. Dave, why don't you say hello to everybody?

David DeCarlo: Hello, everyone. I did want to add one thing on Jamie's question. As you know it's not so much the cost of capital. As Mel said, it's our (model). And I think our competitive advantage is a decentralization concept for a succession planning. We walk the talk, we just don't talk it. And it's been a great, great way to build relationships with the potential acquisitions.

Melvin Payne: Yes. So thank you, everyone, for calling in and your support and interest in our company. We'll talk to you next quarter. Thanks.

Operator: Ladies and gentlemen, thank you for participating in today's conference. That concludes today's program, you may all disconnect. Everyone, have a great day.

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