CSV – Q3 2016 CARRIAGE SERVICES, INC. EARNINGS WEBCAST

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CORPORATE PARTICIPANTS

Mel Payne *Carriage Services Inc. - Chief Executive Officer and Chairman of the Board*

Ben Brink *Carriage Services Inc. – Co-Chief Financial Officer and Treasurer*

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CONFERENCE CALL PARTICIPANTS

Scott Schneeberger *Oppenheimer - Analyst*

Alex Paris *Barrington Research - Analyst*

Chris McGinnis *Sidoti & Company – Analyst*

Joe Yanchunis *Raymond James & Associates – Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for standing by. Welcome to the Carriage Services Inc. third quarter 2016 earnings webcast.

(Operator Instructions)

Now I would like to welcome and turn the call to Ms. Viki Blinderman, Co-Chief Financial Officer. Please go ahead.

Viki Blinderman - ***Carriage Services Inc. - Co-Chief Financial Officer and Chief Accounting Officer***

Thank you and good morning, everyone. We are glad you can join us today. We would like to welcome you to the Carriage Services conference call.

Today, we will be discussing the Company's results after the third quarter which was released yesterday after the market closed. Carriage Services has posted the press release, including supplemental financial tables and information, on its investors page of our website.. This audio conference is being recorded and an archive will be made available on our website.

Additionally, later today, an audio archive of the call will be made available and active through October 30th. Replay information for the call can be found in the press release distributed yesterday. On the call today from management are Mel Payne, Chairman and Chief Executive Officer and Ben Brink and myself, Viki Blinderman, Co-Chief Financial Officers. Today's call will begin with formal remarks from management followed by a question and answer period.

Please note that during the call we will make forward-looking statements in accordance with the Safe Harbor provision of the Private Securities Litigation Reform Act of 1995. I'd like to call your attention to the risk associated with these statements which are more fully described in the Company's report filed on Form 10-K and other filings with the SEC. Forward-looking statements, assumptions or factors stated or referred to on this conference call are based on information available to Carriage Services as of today.

Carriage Services expressly disclaims any duty to provide updates to these forward-looking statements, assumptions or other factors after the date of this call to reflect the occurrence of events, circumstances, or changes in expectations.

In addition, during the course of the morning's call, we will reference certain non-GAAP financial performance measures. Management's opinion regarding the usefulness of such measures together with the reconciliation of such measures to the most directly comparable GAAP measures for historical periods are included in the press release and the Company's filings with the SEC.

Now I'd like to turn the call over to Mel.

Mel Payne - ***Carriage Services Inc. - Chief Executive Officer and Chairman of the Board***

Thank you, Viki. I'm really honored to start off this call about our third quarter and year-to-date performance by naming the Carriage High Performance Heroes. This is an important part of our high performance culture tradition and language. So, the heroes for the third quarter are as follows.

In the east region, Robert Maclary, Kent-Forest Lawn Funeral Home, Panama City; Courtney Charvet, North Brevard Funeral Home & Crematory, Titusville Florida; Sue Keenan, a repeat winner from the first or second quarter; Byron Keenan Funeral Home & Cremation, Springfield Massachusetts; Kim Borselli, Fuller Funeral Home Cremation Service, Naples Florida.

In the central region, Michael Page, Allison Funeral Service, Liberty Texas; Andy Shemwell, Maddux-Fuqua-Hinton Funeral Homes, Hopkinsville Kentucky; Brian Binion, Steen Funeral Homes, Ashland Kentucky and Kyle Incardona, Hillier Funeral Homes, Bryan and College Station Texas.

And in the west, Justin Luyben, Evans Brown Mortuaries, Sun City California; Ken Summers, also a repeat winner from the first or second quarter, P.L. Fry and Son Funeral Home, Manteca California; Verdo Were, McNary-Moore Funeral Service, Colousa California and Steve Mora, also a repeat winner and along with Kyle Incardona, a member of our standards council, Conejo Mountain Memorial Park, Camarillo California -- Steve.

And in the Houston support office, Marisol Britton, Houston Support, information technology.

And with that, I'll turn it over to Ben for more color on the performance.

Ben Brink *- Carriage Services Inc. - Co-Chief Financial Officer and Treasurer*

Thank you, Mel.

Carriage’s third quarter results reflected all of our long term value creation engines firing on all cylinders. We continued to demonstrate fantastic operating results with revenue growth and margin improvement across our business, we closed one acquisition of a leading funeral operator in Madera California, while signing letters of intent with two businesses in strategic markets. All three businesses are perfect examples of our stated goal to partner and affiliate with the best remaining independent funeral home and cemetery operators in the country. Absent one time retirement expenses, we continued to reduce our Overhead expenses while our preneed trust funds had a strong performance and we benefited from a lower tax rate due to a change in calculation of bonus depreciation. As a result, our Adjusted Diluted EPS for the third quarter increased 30.3% over prior year to $.43, while our Adjusted Diluted EPS for the first nine months increased 17.4% from 2015 to $1.28. In our seasonally weakest quarter we also earned a record $17.1 million in Adjusted Consolidated EBITDA while we continued to increase our record and industry leading Adjusted Consolidated EBITDA margin to 29.6% on a year to date basis.

In previous conference calls and in our written material we have talked at length about two key points for investors to understand about the operating characteristics of our company. The first is the tremendous amount of operating leverage that is inherent in the funeral home business at the local level and the second is the operating discipline that results from high performance execution of the Standards Operating Model by a 4E Managing Partner and their teams. The third quarter and year to date performance of our same store funeral portfolio is a testament to that operating discipline and speaks to the quality of 4E Managing Partners and their teams to not allow operating leverage to work against us in a flat or down revenue environment.

While same store revenue was essentially flat for the third quarter, we continued to show incremental improvement in Field EBITDA margins which increased 120 basis points to 37.2%. An even better example of operating discipline is that while revenue has decreased by $1.3 million through the first nine months Field EBITDA has actually increased modestly and margins have improved by 70 basis points to 38.3%.

The third quarter performance of our acquisition funeral portfolio showed both the successful execution of our Strategic Acquisition Model to partner with larger, higher margin businesses that have the potential for higher long term revenue growth and what happens to the operating results of these businesses when led by 4E Managing Partners that execute for high standards achievement. For the quarter our acquisition funeral revenue grew by $1.5 million equal to 18.5% versus prior year while Field EBITDA grew by $720,000 or 22.5% and Field EBITDA margin expanded by 130 basis points to 40.3%. During the first nine months of the year, the acquired funeral segment has grown revenue by almost $4.0 million, Field EBITDA by $2.0 million and expanded Field EBITDA margin by 170 basis points to 41.6%.

Consistent with our stated goal to purchase larger businesses that based on our due diligence and analysis have the ability to have higher revenue growth and higher Field EBITDA margins the year to date Field EBITDA margin of 41.6% in our acquired portfolio is 330 basis points higher than our same store funeral Field EBITDA margin. What is important for investors to understand is that not only do these businesses qualified under our Strategic Acquisition Model have a higher Field EBITDA margin profile when acquired, but we have consistently seen Field EBITDA margin improvement in subsequent years after acquisition. For example, the 16 business we acquired between 2012 and 2014 where we have two full years of data, the average Field EBITDA margin improvement is 330 basis points from the end of the first year as part of Carriage through the current period. Based on our expectation for continual execution of our Acquisition and Operating Models, we anticipate the trend of Field EBITDA margin improvement in acquired businesses to continue.

The third quarter was another period of continued high performance for our managing partners and their teams in our cemetery businesses. Same store cemetery revenue grew $625,000 or 5.8% versus prior year and has grown by $2.5 million or 7.8% for the first nine months of the year. Not to be out done, the two cemeteries in our acquisition portfolio increased revenue by 41.3% in the third quarter. This growth in revenue led to a 16.5% increase in our cemetery field EBITDA for the third quarter and a 10.2% growth in cemetery field EBITDA year to date.

This organic growth in revenue, EBITDA and EBITDA margin demonstrates the ability of our high performance cemetery leadership and sales teams to continue to deliver high value personal sales service to our cemetery customers in each local market. Moreover, these teams have taken full advantage of the strategic investments we have made in many of our cemeteries in recent years which has translated into the average price per property sale increasing approximately 7% year to date. We continue to identify opportunities to make further investments in high value and differentiated cemetery inventory in select markets at rates of return well in excess of our cost of capital.

Financial Revenue and EBITDA were both lower in the third quarter and year to date due to lower preneed funeral contracts maturing, a small reduction of realized perpetual care income and a lower amount of preneed cemetery earnings. The lower amount of financial revenue and EBITDA are in line with our expectations from the beginning of the year.

During the third quarter we continued to lower overhead expenses as a percentage of revenue. Adjusted for one time retirement and severance expenses, overhead as a percentage of revenue would have been 12.2% or a reduction of 160 basis points from third quarter 2015 and 12.7% for the first nine months of the year, a reduction of 90 basis points and approximately $1.1 million. Our third quarter results also benefited from a reduction in non-cash stock compensation due to the retirement of Dave DeCarlo at the end of September.

Looking ahead we expect overhead expenses to be lower by approximately $1.5 million in the fourth quarter versus the prior year based on our expectation for operating results affecting variable compensation accruals and announced retirements from our Operations & Strategic Growth Leadership Team.

Our 25% effective tax rate for the quarter was positively impacted by a $1.1 million discrete tax item related to additional bonus depreciation we were able to accrue in the third quarter. While we had anticipated some benefit to the changes in bonus depreciation that were legislated at the end of last year, we weren't able to determine the full magnitude until our 2015 federal tax return was completed in the quarter. We expect to have additional tax benefit from bonus depreciation in the future, but do not anticipate the amounts to have a material impact going forward. The larger benefit this quarter is directly correlated to the high amount of capital expenditures we completed in 2015.

We currently expect to complete approximately $16 million of capital expenditures this year, which represents an almost 50% decrease from our spending in 2015. The $16 million will be split evenly between maintenance and growth. We originally intended to substantially complete the construction of 2 new funeral homes by the end of the year. We now expect to have one opened by year end with the other completed by the middle of next year.

Year to date our adjusted free cash flow declined by 12% or $4.7 million to $34.1 million. This decrease is entirely due to the timing of federal estimated tax payments compared to last year. We currently estimate that adjusted free cash flow will be approximately equal to 2015 levels of $43.6 million, even though cash taxes paid will be higher by over $2 million versus last year.

A critical, and what we believe, an overlooked aspect of Carriage as a value creation long term investment is our growing free cash flow and our continued ability to turn a higher percentage of revenue into free cash flow. This free cash flow is currently and will continue to be used to generate value for our long term shareholders through disciplined capital allocation.

Our discretionary trust funds had a strong performance in the third quarter with returns of approximately 8% and 10.2% for the first nine months of the year. This performance was led by a rebound in our 10 year TARP warrant portfolio of "Too Big To Fail" bank and insurance companies. As stated in our second quarter conference call, we used this as an opportunity to trim some of our warrant positions, particularly for securities that have an expiration date within the next 2 years.

The fixed income portion of our portfolio continued to track the performance of the overall high yield market with a year to date return of 17.2%. While our entire fixed income portfolio has performed well, the investments we made during the first half of the year have been the primary drivers for our outperformance versus the high yield index. Examples of these fixed income investments include Freeport – McMoran, Williams Companies, Weatherford, Transocean, Seacor Holdings, Western Digital, Dell, Valeant Pharmaceuticals and two high yield closed end funds. The average total return of those investments is currently 35%.

The execution of our trust fund repositioning strategy we announced at the beginning of the year has allowed us to increase the amount of recurring income within the portfolio by 17% or $1.6 million from year end 2015, improve the overall credit quality and liquidity of our fixed income investments and create an even more flexible portfolio to take advantage of what may lie ahead. As conditions have improved over the past 6 months and credit spreads continue to narrow, we have taken the opportunity to exit some older positions and raise approximately $24 million in cash, which is significantly higher than our normal cash position.

We recently closed on Jay Chapel in Madera California a growing community just outside of Fresno and we have signed letters of intent for two first class businesses in strategic markets. We expect those transactions to close within the next 30 days. All three of these business fit the profile within our strategic acquisition model of larger, higher margin businesses that have the ability to grow revenue above 2% compounded over the first five years of being a part of Carriage's High Performance Culture. Much like the owner we quoted in our recent press release, the owners of these three businesses recognized that our culture and standards operating model are unique within our industry and that they had the ability to not 'sell out' but rather join in with a group of other elite local funeral and cemetery businesses within Carriage.

Based on the actual and expected closing of these three acquisitions along with our current expectations for the performance of our business we are raising our rolling four quarter Adjusted Diluted Earnings Per Share range by $.10 to $1.81-$1.85.

As we come to the end of the first five years of our Good To Great Journey we are looking forward to finishing 2016 on a strong note. As our third quarter and year to date results demonstrate, our Managing Partners and their teams continued their disciplined execution of our standards operating model with EBITDA growth at higher margins, we continue to lower our corporate overhead expenses and increase our Adjusted Consolidated EBITDA margin, all while adding first class businesses to our ever improving operating and consolidation platform. All of us here at Carriage are excited for the future of our business and we look forward to sharing our continued Good To Great journey with our shareholders.

And with that, I'll turn it back over to Mel.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Thank you, Ben.

There's no one in Carriage more excited about the future than me. And I get the honor of writing and talking about our Company, our leaders and our people. It's the best job; I can't imagine anyone having a better job. Our Good to Great Journey that we initiated at the beginning of 2012 has been simply amazing to all of us -- whatever our individual role and responsibility -- who have the pleasure and the honor to work at Carriage.

The idea of it being the best mission and vision over the next 10 years in the funeral service and cemetery industry can only be achieved when you unleash the human potential power of the very best leaders and employees at every business and in each of our support departments in complete alignment with our third guiding principal -- a belief in the power of people through individual initiative and team work.

So, I would like to thank each and every one of our employees and leaders who fully understand the key finding by Jim Collins and his Good to Great book research team, that -- quote, "Greatness is not a function of circumstance. Greatness, it turns out, is largely a matter of conscious choice" -- unquote.

Our remarkable performance this year and for the past four years, nine months, profoundly reflects that our wonderful high performance employees and leaders have made the conscious and very personal choice to be great. And we expect the flywheel effect of such multiple choices across the Carriage platform to continue to power our operating and financial performance higher over the next five years because we all choose to be great and the best is yet to come.

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

QUESTION AND ANSWER

Operator

(Operator Instructions)

And our first question is from the line of Scott A. Schneeberger with Oppenheimer. Please go ahead.

Scott Schneeberger - ***Oppenheimer - Analyst***

Mel, you noted on your second quarter call that you and your leadership team were doing an analysis regarding corporate development in your new five year scenario. Just wondering if you could give us an update on that -- any color would be appreciated.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Yes, we're doing an analysis. I said in the third quarter press release that we will grow faster and higher margin than we have in the past; that's what the analysis shows. I just returned -- along with three other members of the Carriage leadership team -- from Philadelphia last night where we had the annual NFDA conference. That's the big one in the funeral business and we met with a number of really strong candidates and wonderful businesses and wonderful markets.

We have something that's unique at Carriage; it's never been created before. It has a lot of momentum right now within the industry. Word is spreading and seeds have been planted and succession plans will continue to be needed. All of the consolidation in the 90's, there's been not a whole lot other than consolidation of consolidators over the last seven or eight years -- 10 years. And so I think you'll have a lot of increased need for succession plan solutions and no one has a framework like we do.

It doesn't exist, never has existed and so I would think the way to think about the future is there's a reason all of us are excited. There's a reason we can -- we know names, we know markets, we know relationships, it's not like this is theoretical anymore. We took the last five years to clean up a lot of things, we had fits and starts of acquisition growth. I think we did exactly what we needed to do to get the platform, to get the leadership ready. We are ready.

The growth will be high quality and faster over the next five years than it has been in the last, long time, since 2007 when we bought seven businesses and added $25 million of revenue. And I see faster growth, I don't want to try to get into modeling it out. We've done that in different scenarios and there's not a bad one, let me just put it that way. A lot of value will be created.

Scott Schneeberger - ***Oppenheimer - Analyst***

Sounds good. Thank you for that color. I'll hop back into the queue.

Operator

And our next question is from the line of Alex Paris with Barrington Research, please go ahead.

Alex Paris - ***Barrington Research - Analyst***

Good morning Mel, morning Ben and Viki. To follow up on that question, and I think you touched on it but your current five-year revenue and cash flow scenario that you publish regularly and most recently in your July investor packet, is that roughly right under -- given that you're cycling through the end of the first five year plan and getting ready to set a new one, and in light of your comments, Mel, now that growth is going to be higher quality and faster over the next five years?Do you anticipate any significant changes to those numbers that are already out there or is it -- is that constantly being updated?

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

That's a wonderful question and absolutely that's a wonderful question. The timing for that question, Alex, could not be better. Having just returned, as I said for a minute, be with our team, we had some wonderful meetings and visits and highly selective. We had other activity, I don't want to get into it too much, calls and across the country while we were there.

And so we're looking very hard at that issue and the reason we're looking so hard at it and really trying to get a better grasp of near term visibility of, let's say, a year or two, but what we found in the past is when you get momentum going on your side, I mean it really carries for a while, and I would expect that 2017 will be a year of momentum for the Company within the industry and then that would carry forward from there. And so one of the things we're doing is, as a team, is revisiting so that at year-end we’ll end our first five year time frame of our good to great journey that never ends, andthen we will reboot the next five years. So what's out there now on our Company Investment Profile is still a carry over from where we were in the first five year time frame and that probably will be changed. How much -- I can't say right now -- but it certainly won't be less. And we'll all put our ideas together and as a team we'll come up with a fresh roughly right range. We'll probably keep the format the same, but we'll take a fresh look at that as well.

We might have an uppercase, might have expected case; I don't know what we're going to do. But we're doing our homework right now and I promise you it will be something you want to own.

Alex Paris - ***Barrington Research - Analyst***

No doubt. So as to timing, when we will expect for you to debut the new five year plan, the new --

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Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

When we report our year-end results.

Alex Paris - ***Barrington Research - Analyst***

Okay, on the year-end call, great.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

I'll stick it right in -- I'm thinking about sticking it right in the press release.

Alex Paris - ***Barrington Research - Analyst***

Perfect.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Rather than the Company investment profile.

Alex Paris - ***Barrington Research - Analyst***

Well, it certainly --

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

That's where we're at.

Alex Paris - ***Barrington Research - Analyst***

-- yes, it certainly sounds like you're enthusiastic and the momentum is clearly building, certainly with...

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Oh, yes.

Alex Paris - ***Barrington Research - Analyst***

... the organic initiative --

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

--I don't think any of us actually needed a plane to fly back from Philadelphia.

Alex Paris - ***Barrington Research - Analyst***

Well, I'm just looking at recent activity. You did two acquisitions in 2015, you've already closed three year-to-date and you have two LOI's signed for acquisitions that should close in the fall --

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Yes, but that's not why we didn't need a plane.

Alex Paris - ***Barrington Research - Analyst***

The -- so with that said, and with Dave DeCarlo's retirement, what does the business development team look like today? Have there been any changes in it or any changes in the approach?

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Yes, there's been some changes in the approach. We were highly focused on huge strategic markets. I would say, five or six we're really hitting hard. A highly focused, highly selective vetting, profiling and trying to determine whether -- it doesn't take a whole lot to figure out what is a good business using our 10 strategic criteria, in a good market, a bigger market.

And so we had the candidates identified in these five or six strategic areas and markets. We're in the process of vastly vetting, profiling and determining what the timeframe might be for a succession plan solution, adult conversation and even more detailed timeframe about something that could be done and how we can help each other minimize after tax proceeds with structure and things like that.

So no, we are very focused -- very accelerated --the entire team is involved, not just Michael Cumby, who's doing a wonderful job with Dave's retirement. It's a complete collaboration and that includes some of our DOS's in the regions and even some of our managing partners.

We have a wonderful business in Philadelphia, where one of the two places we're building is in a suburb of Philadelphia, which has some wonderful suburbs. And this guy's pretty much slayed the competition where he is and grown. And now he's going to build a new place. And I'm sorry for the competition over there, but they'll be his victim. This guy's good.

So we had him with the dinner and an owner and we're all -- we're all in this together, so it’s a team deal.

Alex Paris - ***Barrington Research - Analyst***

Great. Now, looking at narrowing the focus to five or six big strategic markets, you said you've identified the candidates. In an order of magnitude, how many candidates are there? I know there's 20,000 funeral houses.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

I'm not going to go there. There -- there's not 10,000. There's not one and there's not 10,000. That's a losing game. I'm not getting into trying to model out how many acquisitions we'll do in a year because there's some of them are bigger, some of them are not as big. And that doesn't really mean a whole lot, Alex. What you want are the bigger ones.

Alex Paris - ***Barrington Research - Analyst***

Right. Well, I didn't mean to ask how many per year, I just, with the candidate pool. You quantified the number of models --

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Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Oh these are fantastic businesses, I mean it's not like -- I mean it's like I said in the Shareholder Letter -- birds of the feather flock together. When you’re the very best in a market, in an area, I mean what does that mean, and I actually had an investor come down last week and we had this discussion at dinner with our team.

What does it mean to be great in any industry and how many people are, companies are or individuals are? It's a very small percentage. So we don't want to be just doing deals. We want to be doing quality deals with people who enhance reputation. And so I don't want to get into a numbers game on that kind of thing. In fact, I won't.

Alex Paris - ***Barrington Research - Analyst***

I hear you and that is good. And then I just have a micro question, I suppose, for Ben or Viki on the tax rate. Tax rate has been low and you said that - what should we use for a tax rate going forward, since it was lower than I had forecast, in Q4 and maybe in 2017 just -- in some sort of ballpark.

Viki Blinderman - ***Carriage Services Inc. - Co-Chief Financial Officer*** *and Chief Accounting Officer*

Yes, I mean our effective tax rate on our current operations is still holding in at around 40%. The benefit that we received in Q3 kind of brings us down to in the 35% range. I think overall, if you want to do an overall effective rate, it's probably going to be somewhere around 36% by year-end.

Ben Brink - ***Carriage Services Inc.*** - *Co-Chief Financial Officer and* ***Treasurer***

Probably,–Alex, going forward 40% is a safe assumption. And I think the magnitude of our benefit we picked up in this quarter was kind of a one-off deal related to how much CapEx we had last year, which we don't expect that level of spending really going forward, so.

Alex Paris *- **Barrington Research - Analyst***

Got you. So revert back to 40% for the fourth quarter? Obviously, the tax rate of the full year will be lower because of the impact of the third quarter. But 40% on a go-forward basis?

Viki Blinderman *- **Carriage Services Inc. - Co-Chief Financial Officer** and Chief Accounting Officer*

Correct.

Ben Brink *- **Carriage Services Inc. -** Co-Chief Financial Officer and **Treasurer***

Yes.

Alex Paris *- **Barrington Research - Analyst***

Got you. All right, well, thank you very much and congratulations.

Mel Payne *- **Carriage Services Inc. -** Chief Executive Officer and Chairman of the Board*

Alex, thank you. Thank you for your support on your coverage. We'll try to make you look good.

Alex Paris *- **Barrington Research - Analyst***

Thank you.

Operator

And, ladies and gentlemen, as a reminder, to ask a question just press "star" and the number "one."

And our next question is from the line of Chris McGinnis with Sidoti & Company. Please, go ahead.

Chris McGinnis *- **Sidoti & Company - Analyst***

Good morning. Thanks for taking my question and nice quarter.

Ben Brink *- **Carriage Services Inc. -** Co-Chief Financial Officer and **Treasurer***

Thanks, Chris.

Viki Blinderman *- **Carriage Services Inc. - Co-Chief Financial Officer** and Chief Accounting Officer*

Thanks.

Mel Payne *- **Carriage Services Inc. -** Chief Executive Officer and Chairman of the Board*

We've got a great Company so quarter just happens.

Chris McGinnis - ***Sidoti & Company - Analyst***

Yes, sure, of course. I guess two questions. One, maybe can you just talk about your comfort on your debt levels and maybe even after the two likely acquisitions? And maybe with seemingly just a robust market out there in terms of maybe on the M&A side, how high you feel comfortable in bringing up your leverage?

Ben Brink - ***Carriage Services Inc.*** - *Co-Chief Financial Officer and* ***Treasurer***

Yes, Chris, that's a really good question and we are constantly looking at our capital structure and where we feel comfortable on leverage. We've said publicly and we still believe that a range of four to five times is where we'd like to operate the business.

Obviously, we're at the high end of that range today. Given the current level of acquisition activity and what we plan going forward, we don't anticipate our leverage being much above five and should trend down over time. And I think the business that we have, the consistency in operating results really support that level of leverage, and with low cash interest costs that are easily covered by adjusted consolidated EBITDA, we feel really comfortable about our leverage today.

Chris McGinnis - ***Sidoti & Company - Analyst***

Great. Thanks, I appreciate that. And then second, just a small piece. Just wondering, you did talk about the cremation rate picking up in the quarter itself. Is there any rate that I guess would be negative to the business overall and what rate would that increase kind of make you maybe a little bit more scared about the industry?

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Chris, this is Mel, I would say going back to when the Company was founded in '91, if someone had told me 50%, I'd say hey that's very dangerous. That's where we are. I'd say a real dangerous rate would be 110%.

Chris McGinnis - ***Sidoti & Company - Analyst***

Sure.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

But I mean give me a break. We've been setting records and it's been going up. So you tell me, what's the danger level? The key is whether you can use the power of your platform, your people and the way you think and deal with every family to overcome any trend in the short term.

We're at all-time industry adjusted consolidated EBITDA margins and nobody asks us about that. Instead we get asked about the cremation rate and what's dangerous. I don't understand the question.

Chris McGinnis - ***Sidoti & Company - Analyst***

Well, it's a perceived headwind in the industry, so I feel like --

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

-- well, that's the industry's problem.

Chris McGinnis - ***Sidoti & Company - Analyst***

Yes. All right.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

I don't see that being our problem. I view it as an opportunity.

Chris McGinnis - ***Sidoti & Company - Analyst***

I wasn't saying it was a problem for you; I'm asking a question.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Well, I mean I can't speak for the industry --

Chris McGinnis - ***Sidoti & Company - Analyst***

I mean -- the rate picks up, that's all. All right. Well, congrats on a great quarter. I appreciate it.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Thank you.

Chris McGinnis - ***Sidoti & Company - Analyst***

Thanks.

Operator

And our next question comes from the line of [Joe Yanchunis] with Raymond James. Please go ahead.

Joe Yanchunis – Raymond James & Associates – Analyst

Hey, guys, great quarter and good job with -- raised the EBITDA margin, there. I had a couple of questions--

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Hey, Joe? If it's a great quarter, why did you guys say we had a slight miss on EBITDA?

Joe Yanchunis – Raymond James & Associates – Analyst

Well, that was in comparison to our model. But --

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

-- what's the model got to do with our Company?

Joe Yanchunis – Raymond James & Associates – Analyst

Well, that was our projection for how you were going to perform in the quarter.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

You should come here and visit us sometime. I don't think --

Joe Yanchunis – Raymond James & Associates – Analyst

-- love to do that.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

-- that would be very helpful. Then maybe your model --

Joe Yanchunis – Raymond James & Associates – Analyst

-- I agree. Well, I had a couple quick questions, here. So your cash flow from ops was down a little bit in the quarter. And I was wondering if that can all be attributed to the retiring of the lower preneed contracts maturing?

Ben Brink - ***Carriage Services Inc.*** - *Co-Chief Financial Officer and* ***Treasurer***

Really the delta and operating cash flow both on the quarter and year-to-date was entirely attributable to the timing of our federal estimated tax payments. We became a full cash tax payer on a federal level last year.

We had all of our tax payments we paid in the fourth quarter of last year where this year we've been paying estimated payments quarterly. That's going to even out here in the fourth quarter. We expect free cash flow to be on par with where we were last year on an adjusted basis, even with our cash taxes being about $2 million higher than what we paid last year.

Joe Yanchunis – Raymond James & Associates – Analyst

Got it, perfect that makes sense. And then lastly, I was wondering when we can expect the severance expense to more normalize following the December retirements and management --

Ben Brink - ***Carriage Services Inc.*** - *Co-Chief Financial Officer and* ***Treasurer***

-- yes so every large severance and retirement expenses are in our numbers now. We don't see -- we don't have any large severance expenses going forward and overhead as a percentage of revenues should normalize in the fourth quarter and going forward.

And as we said on the call, it's going to be -- versus last year, the fourth quarter will be -- overhead will be down significantly just because I think we've been accruing at a better rate so far, this year.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Hey Joe, I got a question. Since you all covered the sector, does your research show that any Company in the history of death care consolidation has reached a consolidated EBITDA margin of 30% using current accounting methodology?

Joe Yanchunis – Raymond James & Associates – Analyst

It does not, I know that's your goal and you guys are well on your way there.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Oh no, I mean we're almost there with the overhead. Even with the acquisitions, I mean we say that. But I'd just be curious about what you guys think about that since you covered the sector.

Joe Yanchunis – Raymond James & Associates – Analyst

Sure. No I mean that's not something that we've seen you guys are obviously the leaders in the margin category, there. I think --

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

-- well, what do you think it means?

Joe Yanchunis – Raymond James & Associates – Analyst

Well, I think that's largely attributed to the preneed sales focus for the other consolidators and you guys are able to maintain your pricing power.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

That's what you think? That's it.

Joe Yanchunis – Raymond James & Associates – Analyst

I think that's a portion of it.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Yes. You really need to do more homework on our Company and come here and look under the covers. Because if you use the same ideas that you use to explain the sector, you will completely miss the merit of the uniqueness of Carriage which you are currently missing, completely.

Joe Yanchunis – Raymond James & Associates – Analyst

All right well, I will look into that.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

Thank you.

Joe Yanchunis – Raymond James & Associates – Analyst

I'll go lick my wounds.

Operator

And ladies and gentlemen, this concludes our Q&A for today. I would like to turn the call back to Mel Payne for final remarks.

Mel Payne - ***Carriage Services Inc.*** - *Chief Executive Officer and Chairman of the Board*

I have no final remarks other than it's a wonderful time to be at Carriage and to be a large shareholder and an employee and a leader. Thank you very much.

Operator

Ladies and gentlemen, this concludes our program for today. You may all disconnect. Have a wonderful day.