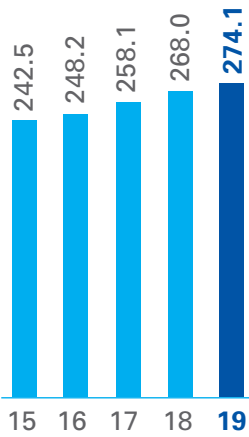




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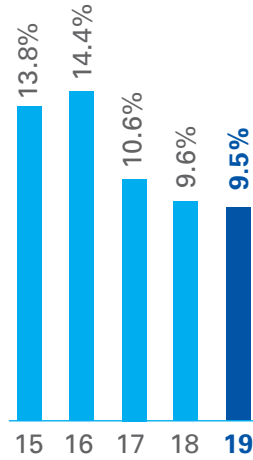
Total Revenue
(In Millions)



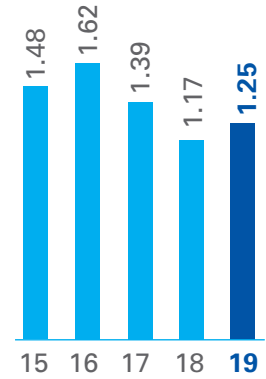
Adjusted Consolidated EBITDA
(In Millions)



Adjusted Return on Equity



Adjusted Diluted Earnings Per Share

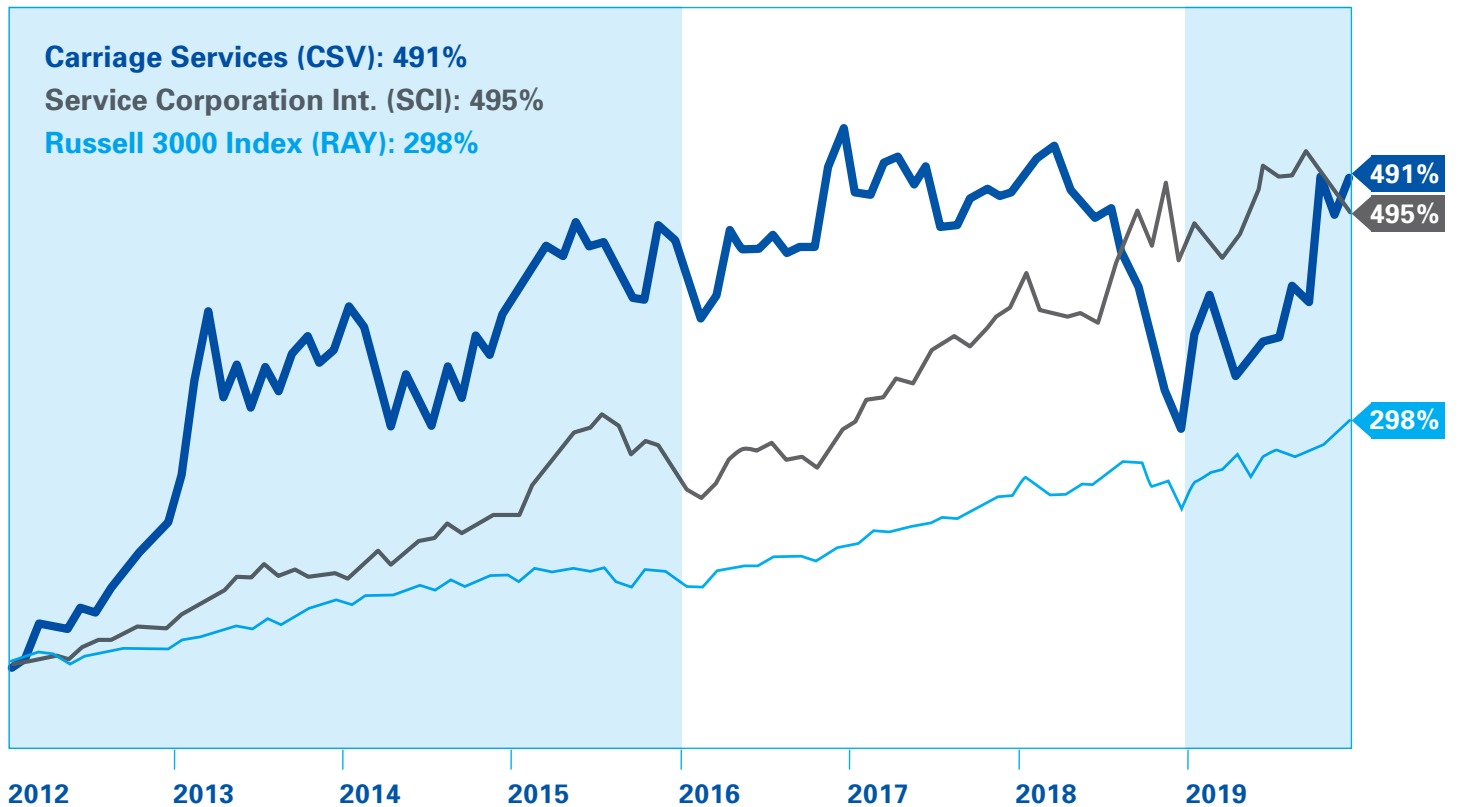


Source: Bloomberg Finance L.P.

Total Return 2012-2019 YTD December *

* Total Return includes stock price appreciation and dividend reinvestment

Copyright: 2019 Bloomberg Finance L.P.



2012-2016
First Five Years
Good To Great Journey –
A New Beginning

2019
Back To The Future –
A New Beginning –
Part II

SHAREHOLDER LETTER

It is Sunday, March 29, 2020, as I now begin to write my Shareholder Letter about **Carriage's 2019 TRANSFORMATIVE YEAR**. Yet from early February when our Executive Team decided on **TRANSFORMATIVE** for the cover of our 2019 Annual Report, our industry, country and indeed most of the world has been engulfed by the rapid spread of the highly contagious and deadly novel Coronavirus that originated in Wuhan, China in December 2019.

I will therefore orient this letter differently than any previous shareholder letter, as I'm certain that all categories of stakeholders in Carriage, including all of our leaders and employees, Board Members, institutional shareholders, bondholders and banks, suppliers, etc., would like to have some sense of how our company will be impacted by the Coronavirus Crisis, now a worldwide pandemic the likes of which hasn't been experienced since the 1918 Spanish Flu Pandemic.

I. Background – State of the Company

In order to understand the Coronavirus Crisis potential impact on Carriage, you will be comforted to learn that the **TRANSFORMATIVE** changes starting in November 2018 that we made in operations and leadership at all levels, capped off in the fourth quarter of 2019 with four large acquisitions and the addition of Bill Goetz as our new President and Chief Operating Officer, has positioned our company as well as possible to weather the current storm. Our industry and company are very different than most others, as death, grieving over lost loved ones and friends, and celebration of lives well lived, has been part of the human condition for thousands of years in all cultures.

Even though we will certainly be impacted in the near term to a degree that isn't yet predictable, we don't expect the decline in our Total Revenues, Adjusted Consolidated EBITDA and Free Cash Flow to be deep enough or last long enough to put our company into a financial and liquidity crisis which many other industries and companies are now facing. We suffered literally little or no operational performance impact in prior national crises including the internet bubble market crash in 2000, the economic aftermath of the 9/11 terrorist attacks (September 11th), or the 2008 / 2009 credit and market crisis that produced The Great Recession.

Yet the current Coronavirus Crisis is decidedly different from these others because of government mandated changes in behaviors that are at conflict with the high social nature of our business. Combined with the natural fear of being infected by someone who may or may not be exhibiting symptoms, client families especially in certain hard hit states and markets are changing their behaviors and choices on the timing and elements of funerals related to memorialization of their loved ones at time of death. Families are also reluctant to meet with our Cemetery Sales Counselors in their homes to plan for a death that hasn't yet happened, impacting our Cemetery Preneed Property Sales.

Our Managing Partners, Sales Managers and their teams of employees, dealing with this crisis family by family on the front lines of this battle against the invisible enemy of Coronavirus, are doing no less courageous even heroic work than the front line army of doctors, nurses, and first responders across America. The huge difference related to our industry is that 85% of those who get infected will not need serious medical attention, and of the 15% who do, about 2% are expected to die.

The serious loss of closure without the traditional ritual of a funeral is a tragedy for the families and friends of those who die because the long healing process of recovering from grief might have been deferred but certainly cannot be denied. At some point over the next few months we believe that our industry and company will be able to return to the noble and healing funeral, interment and memorialization rituals we are entrusted to provide to our client families and their communities.

II. Coronavirus Crisis – State of the Country

While the Coronavirus originated in Wuhan, China, it rapidly spread to other countries in January and February and has had devastating impacts on populations, economies and ways of life globally, particularly Italy, Spain, France, England and Iran as of this writing. Most medical experts predict the already dire situation will get much worse for an indeterminate time before it gets better. The province of Wuhan, China and South Korea seem to be offering glimmers of hope that the novel Coronavirus, while not yet treatable with customized therapies or preventable with new vaccines, can be contained with the right population, medical and governmental responses. The best case scenario predicted by experts at this point is that the health and economic damages could be limited to a three to four month period while still being savagely and tragically severe.

The United States experienced its first Coronavirus death only one month ago in late February at a nursing home in Kirkland, Washington. As of Monday, March 30, 2020, according to data from John Hopkins University, there are more than 181,000 confirmed Coronavirus cases in the United States that have resulted in 3,606 deaths with almost half the cases and deaths in New York City. Other severe outbreaks have occurred in the Seattle area, northern and southern California, New Orleans, New Jersey, Connecticut, and more recently Detroit and Chicago.

The Federal Government under the Trump Administration has led a massive and comprehensive medical, monetary and fiscal stimulus response totaling **\$6.2 Trillion Dollars** to this growing Coronavirus Crisis across our country. This response is by far the largest in history but is likely only the beginning commitment to mitigate the damage to the American people and our economy. Shown below are summary bullet points on just how quickly every facet of the American way of life has been shocked over the last six weeks:

1. Living.

- Thirty-one states with most of the largest cities (California, New York, Illinois, Michigan, Massachusetts, Washington, etc.) are under state mandated “Stay at Home” orders, and other major cities (Houston, Dallas, Philadelphia) in states without such orders are also under municipal “Stay at Home” orders;
- Three quarters of the population equal to about 245 million people are now living under “Stay at Home” orders;
- Schools at all levels and colleges are closed, many for the rest of the school year;
- Gatherings of people for any reason are either prohibited or highly restricted to very small groups (5 to 50 depending on the state), and each day generally brings shrinkage to the group size that is permitted;
- Social distancing, i.e. staying six feet away from anyone for just about any reason, is the new federal guideline for going about daily life; and
- All of the individual behavioral guidelines to mitigate spread of the Coronavirus as of late today were extended through April 30, 2020 by President Trump.

2. Business.

- A majority of businesses have been hugely impacted by the fear and panic and restrictions on their workforce caused by the Coronavirus Pandemic;
- Demand for products and services of just about every category except those critically needed in such a once a lifetime novel pandemic crisis has literally dried up;
- Oil and natural gas prices have collapsed to levels not seen in thirty years because of over production and a plummet in demand;
- Many companies, especially those hardest hit (travel, entertainment, restaurants, energy) have almost overnight had their revenues collapse and are hemorrhaging cash

-
- and desperately struggling for sources of liquidity to bridge the deep economic recession the country has just entered in March; and
- Most of our economy either has been shut down by government orders or from voluntary behavioral changes which will result in tens of millions of likely unemployed workers and numerous bankruptcies over the coming months.

3. Financial Markets.

- After the S&P 500 Index closed at an all-time high of 3,386 on February 19, 2020 (39 days ago), the equity and bond markets collapsed because of fear and panic by investors over the Coronavirus Pandemic, with the S&P 500 plummeting to an intraday low of 2,337 on Monday, March 23rd, down 34% in 33 days, while the DOW Industrials were down 37.1% intraday;
- Bond markets began to freeze up as liquidity was sucked out of bond funds when investors sought safety in cash, exploding yields;
- As the shock of the Coronavirus Pandemic Crisis, having already caused a sudden economic crash and crisis, began to be processed by investors, fears of a financial and credit crisis were made worse by a slow response by the House of Representatives to the fiscal and monetary package passed by the Senate because of the deep political divide in our country;
- A lack of liquidity in the markets and a spike in volatility has characterized both equity and bond markets over the last month with the CBOE Volatility Index (VIX) hitting an all-time high of 82.69 on Monday, March 16, 2020, and the U.S. Ten Year Treasury yield hitting an all-time low of 0.54% on Monday, March 9, 2020, as investors sought safety and the avoidance of any corporate risk;
- Share prices of the most directly and severely impacted companies (airlines, hotels, cruise lines, Boeing, etc.) were down as much as 50% - 80% in one month at the recent market low on March 23, 2020, as were most energy companies that were already way down from the excess production and supply driven by geopolitical dynamics between large producers like Russia and Saudi Arabia;
- Bond yields especially in all high yield categories exploded as the lack of liquidity caused a breakdown in normal price discovery mechanisms, i.e. no buyers "bidding" and sellers willing to "ask" and accept hugely discounted prices from par (30 to 60 cents that one month ago were 100 cents).
- The medical, economic, financial and political crises, compounded by scary worst case reporting by almost all media, all occurring simultaneously and suddenly because of a once in a lifetime novel Coronavirus Pandemic, have defined the Gold Standard for a Black Swan Event, creating an investment environment of uncertainty that is likely to last for months if not much longer.

III. The Transformation of Carriage

Shown below are my verbatim comments about the transformation of Carriage since late 2018 that are from the first 1½ pages of our full year 2019 performance press release issued quite ironically on February 19, 2020, the date of the all-time high in the S&P 500 Index and a week or so before the first Coronavirus death in the U.S. in Kirkland, Washington:

“Our performance in the full year of 2019 was dramatically better than 2018, as we reversed the broadly declining performance trends in our funeral and cemetery portfolios. While we still have much work to do to achieve the optimum performance potential in our existing portfolio, we made two bold and strategic moves in the last quarter of 2019 by recruiting Bill Goetz as President and COO and acquiring four large high quality businesses in great strategic markets with about \$50 million in new high margin revenue once fully integrated into Carriage’s operating model framework.

We believe that in 2019 we positioned Carriage for unprecedented performance and valuation success over the next five years. But no doubt the continuing work to improve performance in our existing portfolio combined with the year-end acquisition and integration of four large businesses in new markets has intensely focused our Operational Leadership and Houston Support Center Leadership Teams on Execution, Execution, Execution. We have therefore determined that the proper way to present our company over the next 3 years is as follows:

1. January 1, 2020 - June 30, 2020 - Integration & Transition.
 - Integrate new acquisitions;
 - Improve funeral and cemetery portfolio performance;
 - Recruit dedicated senior leadership to build and support a high performance cemetery preneed sales culture and system;
 - Divest low performing funeral homes; and
 - Reduce debt from increasing Adjusted Free Cash Flow and divestment proceeds.
2. July 1, 2020 - June 30, 2021 - Normalize increased earnings and Adjusted Free Cash Flow, reducing debt and improving credit profile.
 - Leadership of new acquisitions (existing and newly recruited) fully integrated into high performance framework of Standards Operating Model;
 - Increase Revenue and Total Field and Adjusted Consolidated EBITDA Margin growth trends;
 - Divest any low performing businesses that no longer fit Carriage’s future growth performance profile and apply proceeds to reduction of debt;
 - Refinance our \$400 million of 6.625% eight year senior notes that are callable after June 1, 2021 at 104.969; and
 - Optimize our capital structure and Adjusted Free Cash Flow earning power by issuing new eight to ten year senior notes at a coupon rate in the range around 5% based on current rate environment, saving an estimated \$7 million in annual cash interest expense equivalent to an additional 28¢ of EPS.
3. July 1, 2021 - December 31, 2022 and thereafter - Optimize performance potential within existing portfolio.
 - Achieve annual company milestones in Total Revenue of over \$325 million, Adjusted Consolidated EBITDA of over \$100 million, Adjusted Diluted EPS of over \$2.25 per share and Adjusted Free Cash Flow of over \$60 million; and

- Achieve leverage ratio of approximately 4 times Total Debt/Adjusted Consolidated EBITDA and return to growth by highly selective acquisitions financed primarily with increasing Adjusted Free Cash Flow.

Reflecting back on Carriage's performance decline in 2018, the performance turnaround we have already achieved, and the performance milestones we will achieve over the next three years, our company will have executed what we believe in hindsight will be viewed as a complete Carriage Leadership, Portfolio High Performance, Balance Sheet, Earnings and Free Cash Flow Transformation as a Value Creation Platform.

Shown below is an expanded Milestone Three Year Roughly Right Scenario demonstrating the shareholder value creation opportunity as we enter the next five year timeframe of our **Good To Great Journey**, beginning with:

Carriage Services 2020: Transformative High Performance - Good To Great Journey Part II

The scenario below includes our best "roughly right" estimates regarding our performance in the three distinct time periods as explained above. We will update Carriage's Rolling Four Quarter Outlook when we report our first quarter 2020 performance results", concluded Mr. Payne.

MILESTONE THREE YEAR SCENARIO

Performance Outlook Scenario	Actual	Roughly Right Ranges		
		Years Ending December 31 (millions)		
		2019 A	2020 E	2021 E
Total Revenue	\$274.1	\$315 - \$319	\$320 - \$324	\$328 - \$332
Total Field EBITDA	\$109.8	\$127 - \$131	\$133 - \$137	\$139 - \$144
Total Field EBITDA Margin	40.0%	40% - 41%	41% - 42%	42% - 43%
Adjusted Consolidated EBITDA	\$76.6	\$92 - \$96	\$97 - \$101	\$102 - \$106
Adjusted Consolidated EBITDA Margin	27.9%	29% - 30%	30% - 31%	31% - 32%
Adjusted Diluted EPS	\$1.25	\$1.55 - \$1.65	\$1.92 - \$2.10	\$2.25 - \$2.40
Adjusted Free Cash Flow	\$37.4	\$42 - \$45	\$53 - \$56	\$60 - \$63
Total Debt Outstanding	\$514	\$480 - \$490	\$440 - \$450	\$390 - \$440
Total Debt to EBITDA Multiple	6.7*	5.0 - 5.2	4.3 - 4.5	3.8 - 4.0

*Does not include ProForma EBITDA from 3 acquisitions closed in Q4 2019. CSV bank covenant compliance includes addbacks for ProForma EBITDA.

Even in a normal economic environment, it is unconventional to publish what we called in the February 19, 2020 press release a "**Milestone Three Year Scenario**" with "Roughly Right Ranges" of performance outcomes, as there are always those elements in an environment that are not controllable. But historically, as previously covered, our business has been highly resilient to all kinds of shocks including sudden and deep economic and market declines such as 2008/2009.

But what has happened over only the last six weeks in this country would surely set the Gold Standard for a Black Swan Event. Obviously, we will not achieve our 2020 "Roughly Right Ranges" of performance given that large parts of our portfolio are currently operating under the severe restrictions imposed by a majority of states for an extended period of time.

We will have a much better sense of the impact of the Coronavirus Crisis on our funeral and cemetery performance during the month of April, which will be the first full month of operations

under the broad geographic restrictions of the current crisis environment across most of our country. Yet we remain optimistic that the Coronavirus Crisis will be winding down by June. Therefore, our passionate conviction is that the **TRANSFORMATIVE HIGH PERFORMANCE** that we had expected in 2020 during the first year of the second five year timeframe of **Carriage's Good To Great Journey** will simply have been delayed into 2021 when our great country and economy are on the mend.

IV. Being The Best – Leadership in Times of Crisis

I would like to share with you two emails related to leadership in times of crisis that I recently sent, first to our Managing Partners and Sales Managers in northern California, and secondly to all our field and home office leadership. The responses to these two messages from across our portfolio at all levels has been inspiring and humbling:

“March 17, 2020

On behalf of all our leadership teams across the country and our Board of Directors, and speaking personally from the heart, I want each of you who are being tested to the maximum by the Coronavirus Crisis to know that we would be in your foxhole side by side with you if it were possible. I have a special place in my heart for each of you and know you and your teams are rising to the challenges you are facing day by day and hour by hour with your client families and communities.

Without being biased toward any group of high performance heroes in our company, I believe our Managing Partners and Sales Managers in Northern California are The Best Of The Best in our company. When the going gets tough, the tough get going and show the rest of us what leadership during a once in a lifetime crisis looks like. We will do all we can in the coming weeks to support you with anything you need to get through this together. We love and respect you beyond our ability to express in words.

Take care and stay healthy.

Mel”

“March 20, 2020

This past Tuesday, March 17th, I sent the attached email to our Managing Partners and Sales Managers in Northern California. They were the first to lead their businesses through the Coronavirus Crisis under a “Shelter In Place” order that did not exempt funeral and cemetery operations as “Essential Services”. Since then the Coronavirus has been spreading across our country and impacting certain areas much more seriously than others, as each day brings new challenges and often some confusion to more of our businesses. Yesterday the Federal Government brought more uniformity to the way state and city governments deal with this new crisis, especially with the determination that our business is indeed, as it has always been throughout history, an Essential Service.

The sentiments that I express in the attached email apply to each of you as you and your teams of employees deal with this crisis one family at a time. As the Coronavirus spreads geographically and impacts more of our businesses, we will be challenged individually at the business level and the Houston Support Center level to rise to the occasion and to collaborate like never before as a High Performance Team of Teams under the banner of Carriage.

I am optimistic that within a couple of months our country and its wonderful medical infrastructure and scientists will have successfully dealt with the worst of this crisis and we will be emerging as a country on the mend. In the meantime, I know that each of you will give your best effort with maximum courage and in so doing define what a **Being The Best Standard** is really all about. In closing, I would like to leave you with two quotes from Theodore Roosevelt, who became the country's youngest President in 1901 at 43 years of age after President William McKinley was assassinated.

On Effort: "Nothing in this world is worth having or worth doing unless it means effort, pain, difficulty."

On Courage: "A soft, easy life is not worth living, if it impairs the fiber of brain and heart and muscle. We must dare to be great; and we must realize that greatness is the fruit of toil and sacrifice and high courage... For us is the life of action, and strenuous performance of duty."

With the greatest respect and love from our Houston Support Center, Leadership Team and Board of Directors.

Mel"

I have traditionally ended my internal annual Theme Letters and external Shareholder Letters with a famous quote from Jim Collins' bestselling book, ***Good To Great (2001)***, as shown below:

"Greatness is not a function of circumstance. Greatness, it turns out, is largely a matter of conscious choice."

With our country in a once in a lifetime crisis, I would instead like to end this shareholder letter by sharing three quotes from John F. Kennedy, one of the greatest presidents in our history, who when sworn into office on January 20, 1961 became the youngest elected president in our history at 43 years of age. Jack Kennedy was about one year younger than Theodore Roosevelt when Roosevelt succeeded to the presidency in 1901 after President McKinley was assassinated. The tragic irony is that America suffered one of its greatest visionary leadership losses in our history when President Kennedy was assassinated in his prime on November 22, 1963.

"Efforts and courage are not enough without purpose and direction."

"The one unchangeable certainty is that nothing is unchangeable or certain."

"Ask not what your country can do for you; ask what you can do for your country."

Speaking on behalf of all the leadership and employees of Carriage and our Board of Directors, we would like to salute all Americans but especially the powerful army of warriors in the first responder, healthcare and deathcare industries as well as our military who are rising to the challenge of doing their best with maximum courage to win the war against the Coronavirus Pandemic.

We live in the greatest country in the history of the world, yet too many Americans do not seem to appreciate the exceptionalism and opportunity in this great land. It is time for every American to set aside all differences of whatever nature and to ask what we can do for our country. When every American makes this "conscious choice" to serve our country in this time of national crisis, and to help as best they can those fellow Americans most in need of our help, I believe with all my heart and soul that America will emerge from the Coronavirus Pandemic Crisis united in victory over this invisible enemy.

Melvin C. Payne

Chief Executive Officer and Chairman of the Board

CARRIAGE 2019 PINNACLE OF SERVICE AWARD WINNERS – HIGH PERFORMANCE HEROES

I am delighted to announce that we had 39 businesses (36 funeral homes and 3 cemeteries) which earned Pinnacle Awards and **Being The Best** Standards Achievement Incentive Bonuses for the Managing Partners and employees of each business. This group of winners represented the Company's **High Performance Culture** well as their businesses contributed \$82.0 million in revenue (30% of Total of \$274.1 million), \$36.1 million in Field EBITDA (33% of Company Total of \$109.8 million) and a EBITDA Margin of 44.1% (Total Company Field EBITDA Margin of 40.0%).

The 39 Pinnacle Award winners included 34 businesses (33 funeral homes and 1 cemetery) which averaged 70% Standards Achievement over the 3 year period 2017-2019 (5 of these businesses also achieved 100% in 2019 under the updated/ rebooted Performance Standards), and 5 businesses (3 funeral homes and 2 cemeteries) which had 100% Standards Achievement in 2019.

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 Carriage's **Being The Best Pinnacle Of Service Award** winners for 2019:

“Being The Best” Pinnacle Of Service Award

Courtney Charvet	North Brevard Funeral Home
Patrick Schoen	Jacob Schoen & Son
Matthew Simpson	Fry Memorial Chapel
Justin Luyben	Evans-Brown Mortuaries & Crematory
Alan Kerrick	Dakan Funeral Chapel
Jeff Hardwick	Bryan & Hardwick Funeral Home
James Bass	Emerald Coast/McLaughlin Mortuary
Randy Valentine	Dieterle Memorial Home & Cremation
Sue Keenan	Byron Keenan Funeral Home & Cremation
Todd Muller	All Cremation Options
Jason Cox	Lane Funeral Home - South Crest
Jeff Seaman	Dwayne R. Spence Funeral Homes
Dan Simons	Everly Community Funeral Care
Mike Conner	Conner-Westbury Funeral Home
Ashley Vella	Deegan Funeral Chapels
Jason Higginbotham	Lakeland Funeral Home
Joseph Newkirk	Civic Center Chapel
Robert Maclary	Kent-Forest Lawn Funeral Home
Ken Duffy	John E. Day Funeral Home
Scott Sanderford	Everly Wheatley Funeral Home
Phil Appell	Keenan Funeral Home
Joseph Waterwash	Baird-Case Jordan-Fannin Funeral Home & Cremation Center
Jeff Steadman	Sansone Funeral Home
Tom O'Brien	O'Brien Funeral Home
Chris Chetsas	Cataudella Funeral Home
*Nicholas Welzenbach	Darling & Fischer Funeral Homes
	Los Gatos Memorial Park
*Tim Hauck	Harvey-Engelhardt/Fuller Metz
	Lee County Cremation

**Qualified for 2 Businesses*

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

Ken Summers	P.L. Fry & Sons Funeral Home
Steve Mora	Conejo Mountain Funeral Home
Brian Binion	Steen Funeral Homes
James Terry	James J. Terry Funeral Homes
Cyndi Hoots	Schmidt Funeral Homes

“Being The Best” 100% Of Standards Award

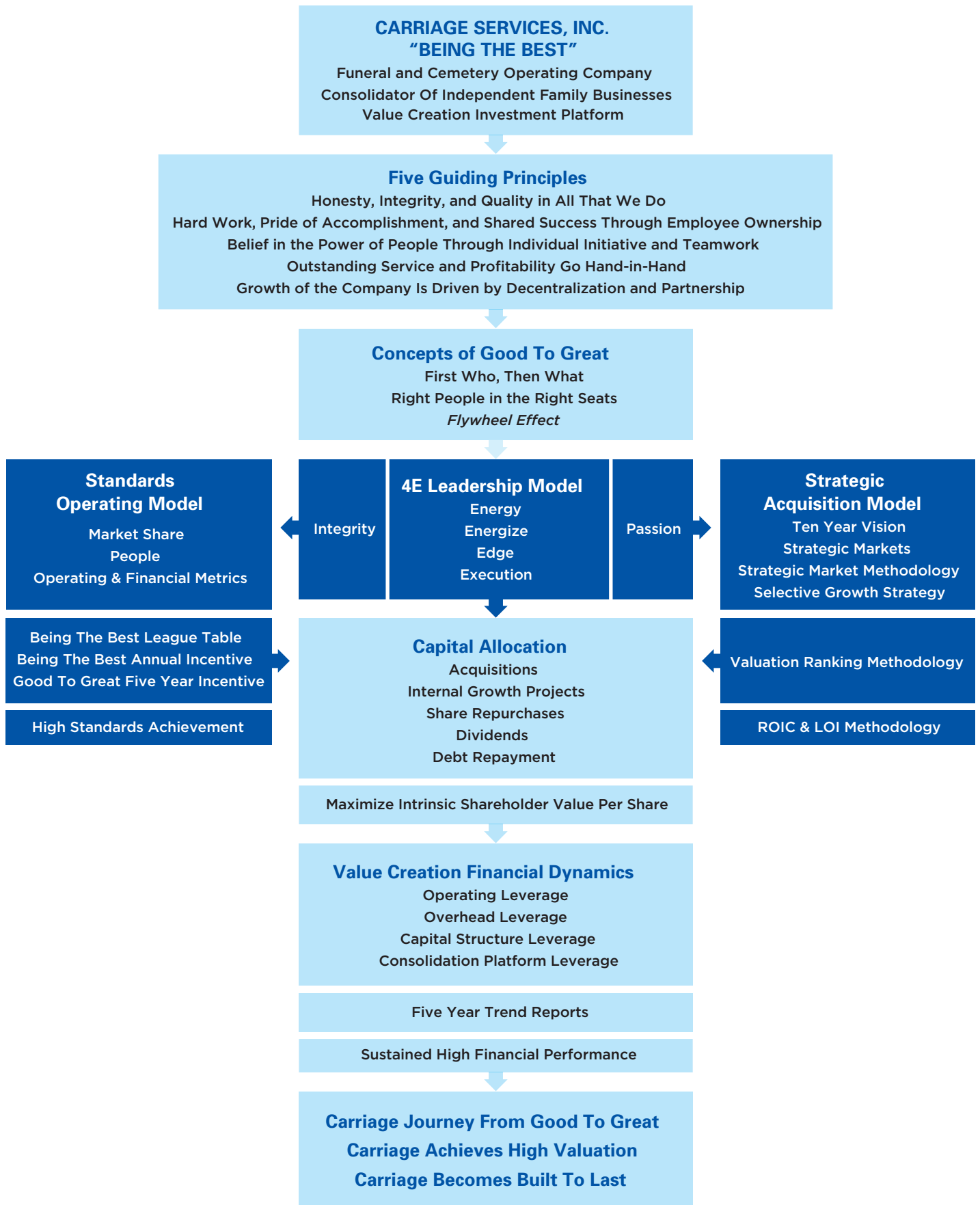
JoAnna DiSibio	Oak View Memorial Park
Anthony Rodriguez	Higgins Mortuary
Ben Friberg	Heritage Funeral Home & Crematory
David Keller	Lane Funeral Homes - Coulter Chapel
Michael Page	Sterling-White Cemetery

CARRIAGE 2019 GOOD TO GREAT AWARD WINNERS

Our five year incentive award, called the **Good To Great Award**, is 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** in 2012 by High Performance Hero Funeral and Cemetery Managing Partners and Sales Managers and their teams of winning employees, so I am more than honored to announce our fourth group of **Good To Great Award** winners that sustained a high level of Standards Achievement and Financial Performance while compounding revenue at 3.1% for the five year timeframe that began in 2015 and ended at year end 2019, as listed below:

Todd Muller	Muller-Thompson Funeral Chapel & Cremation Services
Alan Kerrick	Dakan Funeral Chapels
Nicholas Welzenbach	Darling Fischer Funeral Homes
Scott Sanderford	Everly Wheatley Funeral Home
Patrick Schoen	Jacob Schoen & Son
Charlie Eagan	Greenwood Funeral Home

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, Financial and Other EBITDA", "Total Field EBITDA", "Total Field EBITDA Margin", "Divested/Planned Divested Revenue", "Divested/Planned Divested EBITDA", "Divested/Planned 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.carriageservices.com.

(in thousands, except per share amounts)	2015	2016	2017	2018	2019	CAGR
Same Store Contracts						
Atneed Contracts	24,356	24,179	25,069	25,117	25,844	
Preneed Contracts	5,936	5,728	5,840	5,721	5,700	
Same Store Funeral Contracts	30,398	30,010	30,909	30,838	31,544	0.9%
Acquisition Contracts						
Atneed Contracts	265	1,097	2,110	3,404	4,896	
Preneed Contracts	46	111	304	450	586	
Acquisition Funeral Contracts	311	1,208	2,414	3,854	5,482	
Total Funeral Contracts	30,709	31,218	33,323	34,692	37,026	4.8%
Funeral Operating Revenue						
Same Store Revenue	\$ 163,829	\$ 162,968	\$ 168,173	\$ 166,934	\$ 167,246	0.5%
Acquisition Revenue	2,266	7,978	16,388	26,835	33,146	
Funeral Operating Revenue	\$ 166,095	\$ 170,946	\$ 184,561	\$ 193,769	\$ 200,392	4.8%
Cemetery Operating Revenue						
Same Store Revenue	\$ 42,078	\$ 43,730	\$ 43,242	\$ 45,135	\$ 49,455	4.1%
Acquisition Revenue	-	-	-	-	295	
Cemetery Operating Revenue	\$ 42,078	\$ 43,730	\$ 43,242	\$ 45,135	\$ 49,750	4.3%
Financial Revenue	\$ 18,080	\$ 17,262	\$ 16,058	\$ 15,977	\$ 16,022	-3.0%
Other Revenue	\$ -	\$ -	\$ -	\$ -	\$ 748	
Divested/Planned Divested Revenue	\$ 16,249	\$ 16,262	\$ 14,278	\$ 13,111	\$ 7,195	-18.4%
Total Revenue	\$ 242,502	\$ 248,200	\$ 258,139	\$ 267,992	\$ 274,107	3.1%
Field EBITDA						
Same Store Funeral Field EBITDA	\$ 64,730	\$ 64,755	\$ 66,668	\$ 63,119	\$ 63,938	-0.3%
Same Store Funeral Field EBITDA Margin	39.5%	39.7%	39.6%	37.8%	38.2%	
Acquisition Funeral Field EBITDA	937	3,318	5,633	9,732	12,547	
Acquisition Funeral Field EBITDA Margin	41.4%	41.6%	34.4%	36.3%	37.9%	
Funeral Field EBITDA	\$ 65,667	\$ 68,073	\$ 72,301	\$ 72,851	\$ 76,485	3.9%
Funeral Field EBITDA Margin	39.5%	39.8%	39.2%	37.6%	38.2%	
Same Store Cemetery Field EBITDA	\$ 14,685	\$ 14,926	\$ 13,406	\$ 13,880	\$ 17,055	3.8%
Same Store Cemetery Field EBITDA Margin	34.9%	34.1%	31.0%	30.8%	34.5%	
Acquired Cemetery Field EBITDA	-	-	-	-	73	
Acquired Cemetery Field EBITDA Margin	0.0%	0.0%	0.0%	0.0%	24.8%	
Cemetery Field EBITDA	\$ 14,685	\$ 14,926	\$ 13,406	\$ 13,880	\$ 17,128	3.9%
Cemetery Field EBITDA Margin	34.9%	34.1%	31.0%	30.8%	34.4%	
Financial EBITDA	\$ 16,698	\$ 16,123	\$ 14,743	\$ 14,427	\$ 14,419	-3.6%
Financial EBITDA Margin	92.4%	93.4%	91.8%	90.3%	90.0%	
Other EBITDA	\$ -	\$ -	\$ -	\$ -	\$ 298	
Other EBITDA Margin	0.0%	0.0%	0.0%	0.0%	39.8%	
Divested/Planned Divested EBITDA	\$ 4,489	\$ 5,291	\$ 4,062	\$ 3,155	\$ 1,437	-24.8%
Divested/Planned Divested EBITDA Margin	27.6%	32.5%	28.4%	24.1%	20.0%	
Total Field EBITDA	\$ 101,539	\$ 104,413	\$ 104,512	\$ 104,313	\$ 109,767	2.0%
Total Field EBITDA Margin	41.9%	42.1%	40.5%	38.9%	40.0%	
Overhead	\$ 34,667	\$ 35,898	\$ 36,430	\$ 36,993	\$ 37,554	2.0%
Overhead as a percentage of Revenue	14.3%	14.5%	14.1%	13.8%	13.7%	
Consolidated EBITDA	\$ 66,872	\$ 68,515	\$ 68,082	\$ 67,320	\$ 72,213	1.9%
Consolidated EBITDA Margin	27.6%	27.6%	26.4%	25.1%	26.3%	
Other Expenses and Interest						
Depreciation & Amortization	\$ 13,780	\$ 15,421	\$ 15,979	\$ 17,430	\$ 17,771	
Non-Cash Stock Compensation	4,444	2,890	3,162	6,583	2,153	
Interest Expense	10,559	11,738	12,948	21,109	25,522	
Accretion of Discount on Convert. Sub. Notes	3,454	3,870	4,329	2,192	241	
Loss on Early Extinguishment of Debt	-	567	-	502	-	
Other, Net	45	1,788	(1,118)	1,238	4,110	
Pretax Income	\$ 34,590	\$ 32,241	\$ 32,782	\$ 18,266	\$ 22,416	-10.3%
Net Tax Provision (Benefit)	13,737	12,660	(4,411)	6,621	7,883	
GAAP Net Income	\$ 20,853	\$ 19,581	\$ 37,193	\$ 11,645	\$ 14,533	-8.6%
Special Items, Net of tax	\$ 6,508	\$ 8,757	\$ (12,444)	\$ 9,921	\$ 7,999	
Adjusted Net Income	\$ 27,361	\$ 28,338	\$ 24,749	\$ 21,566	\$ 22,532	-4.7%
Adjusted Net Profit Margin	11.3%	11.4%	9.6%	8.0%	8.2%	
Reconciliation of Consolidated EBITDA to Adjusted Consolidated EBITDA						
Consolidated EBITDA	\$ 66,872	\$ 68,515	\$ 68,082	\$ 67,320	\$ 72,213	1.9%
Special Items	\$ 4,261	\$ 5,176	\$ 620	\$ 2,872	\$ 4,374	
Adjusted Consolidated EBITDA	\$ 71,133	\$ 73,691	\$ 68,702	\$ 70,192	\$ 76,587	1.9%
Adjusted Consolidated EBITDA Margin	29.3%	29.7%	26.6%	26.2%	27.9%	
GAAP Diluted EPS	\$ 1.12	\$ 1.12	\$ 2.09	\$ 0.63	\$ 0.80	-8.1%
Adjusted Diluted EPS	\$ 1.48	\$ 1.62	\$ 1.39	\$ 1.17	\$ 1.25	-4.1%
Average Number of Diluted Shares Outstanding	18,313	17,460	17,715	18,374	18,005	-0.4%
GAAP Basic EPS	\$ 1.16	\$ 1.18	\$ 2.25	\$ 0.64	\$ 0.81	-8.6%
Adjusted Basic EPS	\$ 1.52	\$ 1.71	\$ 1.50	\$ 1.19	\$ 1.26	-4.6%
Average Number of Basic Shares Outstanding	17,791	16,515	16,438	17,971	17,877	0.1%



Carriage Services

2019 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, 2019

or

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:

<u>Title of each class</u>	<u>Trading Symbol</u>	<u>Name of each exchange on which registered</u>
Common Stock, Par Value \$.01 Per Share	CSV	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 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 28, 2019 was approximately \$308.0 million based on the closing price of \$19.01 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 21, 2020 was 17,873,388.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information required to be disclosed in Part III of this report is incorporated by reference from the registrant's definitive proxy statement or an amendment to this report, which will be filed with the SEC not later than 120 days after the end of the fiscal year covered by this report.

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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, revenues, 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 of the plans, timing and objectives of management for acquisition and divestiture activities; any statements of the plans, timing, expectations and objectives of management for future financing activities; 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 effects of competition;
- the execution of our Standards Operating, 4E Leadership and Strategic Acquisition Models;
- 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;
- our ability to consummate the divestiture of certain businesses as currently expected, if at all;
- our ability to meet the timing, objectives and cost saving expectations related to anticipated financing activities;
- 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 litigation and burial practice claims;
- 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;
- our ability to integrate acquired businesses with our existing business; 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, 2019, we operated 186 funeral homes in 29 states and 31 cemeteries in 11 states. We compete with other publicly held and independent operators of funeral and cemetery companies. 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. On October 9, 2019, we acquired four funeral home businesses in Buffalo, New York. On October 28, 2019, we acquired one funeral home and cemetery combination business, three funeral home businesses and three ancillary service businesses, which include a flower shop, a pet cremation business and an online cremation business, in the Dallas, Texas area. On December 31, 2019, we acquired a funeral home and cemetery combination business in Fairfax, Virginia. 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 of operations from the date of acquisition.

Executive Leadership Changes. On December 2, 2019, William (Bill) Goetz joined our executive leadership team as President and Chief Operating Officer and was also elected to serve as a member of our Board of Directors.

Share Repurchase Program. On July 31, 2019, our Board approved a share repurchase program authorizing us to purchase an additional \$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”). During the year ended December 31, 2019, we repurchased 400,000 shares of common stock for a total cost of approximately \$7.8 million at an average cost of \$19.39 per share pursuant to this share repurchase program. Based on all repurchases to the date of this Annual Report on Form 10-K and increases in authorization, we have approximately \$25.6 million available for repurchase under our approved program.

Dividends. During 2019, we paid \$5.4 million in dividends.

Additional Senior Notes. On December 19, 2019, we issued an additional \$75.0 million in aggregate principal amount of 6.625% Senior Notes due 2026 (the “Additional Senior Notes”) and related guarantees by our subsidiary guarantors in a private offering under Rule 144A and Regulation S of the Securities Act of 1933, as amended (the “Securities Act”). The Additional Senior Notes were issued as additional securities under the indenture by and among us, our subsidiary guarantors and Wilmington Trust, National Association, as trustee, pursuant to which \$325.0 million in aggregate principal amount of 6.625% Senior Notes due 2026 (the “Initial Senior Notes” and, together with the Additional Senior Notes, the “Senior Notes”) issued by us in May 2018.

Divestitures. During 2019, we divested three funeral home businesses whose building leases expired and sold a funeral home business for \$0.9 million. In addition, we merged a funeral home business with a business in an existing 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, 2019 from the United States Department of Commerce).

Deaths and Death Trends

During 2019, the number of deaths in the United States increased by approximately 2.2% following a 1.3% and a 2.5% increase in 2018 and 2017, 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 42.8 million in 2018 and is expected to grow 2.0% to 47.2 million by 2023, making this the second fastest-growing age group, while the fastest-growing segment of the population is Americans aged 65 and older, with 52.3 million in 2018. This age group is expected to increase to 60.0 million in 2023, reflecting an average annual growth rate of 2.8%. Overall, from 2018 to 2023, the number of deaths in the United States is expected to increase by an average of 2.0% per year, reaching an estimated 3.15 million in 2023.

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 2019, the number of burials in the United States decreased by an estimated 1.2%, following declines of 2.2% and 0.5% in 2018 and 2017 respectively. The number of burials in the United States is estimated to fall by an average of 1.0% per year from 2018 through 2023. In 2023, it is estimated that there will be approximately 1.26 million burials in the United States and a burial rate of 40.2%.

In 2019, the number of cremations in the United States increased by an estimated 5.2%, following increases of 4.5% and 5.6% in 2018 and 2017, respectively. Slower growth is expected through 2023, 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 4.4% per year from 2018 through 2023. In 2023, it is estimated that there will be approximately 1.88 million cremations in the United States and a cremation rate of 59.8%.

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 with operations in the United States are Service Corporation International (“SCI”), StoneMor Partners L.P. (“StoneMor”), Park Lawn Corporation, traded on the Toronto Stock Exchange (“Park Lawn”) and Carriage. We believe these four 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, providing personalized high-value services to our client families and guests, and operating 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, high-value services 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**,” which began in 2012, 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. The growth rate was changed to 1% beginning with the 2019 payout year, which impacts all five-year performance periods ending on or after December 31, 2019. After each five year incentive plan is achieved and paid out, a new five year plan period begins. To date, we have had four performance periods in which we have paid \$5.1 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 criteria such as cultural alignment, volume and price trends, size of business, size of market, competitive standing, demographics, strength of brand and barriers to entry to evaluate the strategic position of potential acquisition candidates. Our financial 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 Burial and Cremation Services. Personalization and pre-planning continue to be two of the most important trends in the funeral and cemetery industry, but the national trend 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 as the method of disposition was 51.4% for the year ended December 31, 2017, 52.2% for the year ended December 31, 2018 and 53.7% for the year ended December 31, 2019. 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 burial service, we have found that this revenue can be substantially enhanced by offering additional services and merchandise, including 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 our local funeral directors with sales sourced by our own sales counselors and by third party sellers.

Preneed Cemetery Sales Program. Our preneed cemetery strategy is to build family heritage in our cemeteries by selling property and interment rights prior to death through full time, highly motivated and entrepreneurial local sales teams. Approximately 50% 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 may have a significant impact on our preneed sales success rate.

OUR STRENGTHS

Market Leader. We compete with other publicly held 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 less subject to 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 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 a range of support services is provided from our home office 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 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 2019 totaled \$43.2 million, which was used primarily for the acquisition of funeral home and cemetery businesses, capital expenditures and our working capital needs, including payment of dividends and our debt obligations. During 2020, we intend to focus on integrating our newly acquired businesses and to use our cash flow to fund 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 flow to repurchase shares of our common stock and remaining 2.75% convertible subordinated notes due 2021. 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 home office in Houston, 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 4E (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 home office in Houston. 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, 2019, we operated 186 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 23 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.

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 by 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, 2019, we operated 31 cemeteries in 11 states. Cemetery revenue currently accounts for approximately 20% of our total revenue. The cemetery operations are led 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 23 for segment data related to our cemetery operations.

Our cemeteries provide 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).

Our cemetery operations are subject to many of the profitability factors as our funeral home business, as well as 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 8,303 and 8,410 preneed funeral contracts, net of cancellations, during the years ended December 31, 2018 and 2019, respectively. At December 31, 2019, we had a backlog of 98,493 preneed funeral contracts and 58,256 preneed cemetery contracts to be delivered in the future. Approximately 20% of our funeral contract volumes during the years ended December 31, 2018 and 2019 originated through preneed contracts. Cemetery revenue that originated from preneed contracts represented approximately 65% and 66% of our total cemetery revenue for 2018 and 2019, respectively.

At December 31, 2019, we employed a staff of 126 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, 2019, CSV RIA provided these services to approximately 71% 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 not reflected in our revenue 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 \$523.1 million as of December 31, 2019.

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 2018 and 2019. Cemetery merchandise and service trust fund balances totaled \$72.4 million as of December 31, 2019.

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 \$64.0 million at December 31, 2019.

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 held companies with operations in the United States include SCI, StoneMor, Park Lawn 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. The FTC has announced that it is reviewing the Funeral Rule, which may result in changes to the Funeral Rule. Among the subjects under review by the FTC is whether the scope of the Funeral Rule should be expanded to cover cemetery sales and merchandise and mandated disclosure of online pricing. We cannot predict what changes, if any, may be made to the Funeral Rule or the impact of any such changes on our business.

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 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, 2019, we and our subsidiaries employed 2,797 employees, of whom 1,137 were full-time and 1,660 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 our 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 Annual Report on 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.

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, high-value services 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. The types of services and the prices offered on such services by our competitors 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 long-term value creation, 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 1% (the “Minimum Growth Rate”) over a five year performance period (the “Performance Period”) with respect to our funeral homes that they operate. The Minimum Growth Rate was changed from 2% to 1% beginning with the 2019 payout year, which impacts all five-year performance periods ending on or after December 31, 2019. 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, 2017, 2018 and 2019:

	<u>2017</u>	<u>2018</u>	<u>2019</u>
Preneed funeral trust funds	11.5%	(6.5)%	21.2%
Preneed cemetery trust funds	13.1%	(8.4)%	26.0%
Perpetual care trust funds	12.8%	(8.0)%	25.2%

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 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.

Changes in taxation as well as the inherent difficulty in quantifying potential tax effects of business decisions could have a material adverse effect on the results of our operations, financial condition, or cash flows.

We make judgments regarding the utilization of existing income tax credits and the potential tax effects of various financial transactions and results of operations to estimate our obligations to taxing authorities. Tax obligations include income, franchise, real estate, sales and use, and employment-related taxes. These judgments include reserves for potential adverse outcomes regarding our tax positions. Changes in federal, state, or local tax laws, adverse tax audit results, or adverse tax rulings on positions taken could have a material adverse effect on the results of our operations, financial condition, or cash flows.

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

The terms of our 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 (including guarantees thereof); 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 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 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, 2019, we had \$497.1 million of total debt (excluding debt issuance costs, debt discounts, debt premium and lease obligations), consisting of \$7.0 million of acquisition debt (consisting of deferred purchase price and promissory notes payable to sellers of businesses we purchased), \$6.3 million of our Convertible Notes, \$400.0 million of our Senior Notes and \$83.8 million of outstanding borrowings under our Credit Facility, with \$104.2 million of availability under our 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 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 our 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, 2019 and our annual review of long-lived assets as of December 31, 2019, we recorded an impairment for tradenames of \$0.2 million and concluded that there was no impairments of our goodwill or other long-lived assets. However, we recorded an impairment of \$0.5 million during 2019, related to a funeral home business that we divested in the fourth quarter of 2019 and \$0.2 million related to a funeral home business we intend to sell in 2020, 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.

The funeral and cemetery industry is competitive.

The funeral and cemetery industry is characterized by a large number of locally-owned, independent operations in the United States. To compete successfully, our funeral service locations and cemeteries must maintain good reputations and high professional standards, as well as offer attractive products and services at competitive prices. In addition, we must market ourselves in such a manner as to distinguish us from our competitors. We have historically experienced price competition from independent and publicly held funeral service and cemetery operators, monument dealers, casket retailers, low-cost funeral providers, and other nontraditional providers of merchandise and services. If we are unable to successfully compete, our financial condition, results of operations, and cash flows could be materially adversely affected.

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 incur 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 may assume the liability for any audit adjustments for our acquired businesses for periods under audit that were prior to our ownership of the business depending upon the obligations outlined in the agreement. 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.

Unfavorable results of litigation could have a material adverse impact on our financial statements.

We are subject to a variety of claims and lawsuits in the ordinary course of our business. Adverse outcomes in potential litigation related to our business may result in significant monetary damages or injunctive relief against us, as litigation and other claims are subject to inherent uncertainties. Any such adverse outcomes that may arise in the future, could have a material adverse impact on our financial position, results of operations, and cash flows.

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 improper burial practices. When disputes occur, we may be subjected to litigation and liability for improper burial practices. 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 burial practices could have a material adverse impact on our financial condition, results of operations and cash flows.

Failure to maintain effective internal control over financial reporting could adversely affect our results of operations, investor confidence, and our stock price.

The accuracy of our financial reporting depends on the effectiveness of our internal control over financial reporting. Internal control over financial reporting can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements and may not prevent or detect misstatements because of its inherent limitations. If we do not maintain effective internal control over financial reporting or implement controls sufficient to provide reasonable assurance with respect to the preparation and fair presentation of our financial statements, we could be unable to file accurate financial reports on a timely basis, and our results of operations, investor confidence, and stock price could be materially adversely affected.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

At December 31, 2019, we operated 186 funeral homes in 29 states and 31 cemeteries in 11 states. We own the real estate and buildings for 165 of our funeral homes and lease 21 facilities. We own 30 cemeteries and operate one cemetery under a long-term contract with a municipality, which we refer to as a managed property. We operate 18 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 31 cemeteries that we operate have developed cemetery property of approximately 129,000 and 152,000 units available-for-sale at December 31, 2018 and 2019, respectively. In addition, we own approximately 500 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, 2019, 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	3	—	—	—
Idaho	5	1	3	—
Illinois	2	—	1	—
Kansas	2	—	—	—
Kentucky	7	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	10	1	—	—
North Carolina	7	1	1	—
Ohio	5	—	—	—
Oklahoma	6	—	2	—
Pennsylvania	2	—	—	—
Rhode Island	4	—	—	—
Tennessee	5	—	—	—
Texas	24	1	8	—
Virginia	8	1	1	—
Washington	2	—	—	—
West Virginia	1	—	—	—
Wisconsin	1	—	—	—
Total	165	21	30	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 home office occupies approximately 48,000 square feet of leased office space in Houston, Texas. At December 31, 2019, we owned and operated 806 vehicles.

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

	Years Ended December 31,		
	2017	2018	2019
Funeral homes at beginning of period	170	178	182
Acquisitions	7	4	9
Constructed funeral homes	2	—	—
Divestitures	(1)	—	(4)
Mergers of funeral homes	—	—	(1)
Funeral homes at end of period	<u>178</u>	<u>182</u>	<u>186</u>
Cemeteries at beginning of period	32	32	29
Acquisitions	—	—	2
Divestitures	—	(3)	—
Cemeteries at end of period	<u>32</u>	<u>29</u>	<u>31</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 18.

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 and was approved by the Court in October 2019. We paid \$0.7 million under the settlement agreement in November 2019.

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 21, 2020, there were 17,873,388 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 5,300 beneficial owners of our common stock.

RECENT SALES OF UNREGISTERED SECURITIES

During the year ended December 31, 2019, 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 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 bringing the total authorized repurchase amount to \$40.0 million. On July 31, 2019, our Board approved an additional \$25.0 million for repurchases of our common stock in accordance with the Exchange Act.

During the year ended December 31, 2019, we repurchased 400,000 shares of common stock for a total cost of \$7.8 million at an average cost of \$19.39 per share pursuant to our 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. 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. 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, 2019, we had approximately \$25.6 million available for repurchase under our share repurchase program.

The following table sets forth certain information with respect to repurchases of our common stock during the quarter ended December 31, 2019:

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, 2019 - October 31, 2019	—	\$ —	—	\$ 25,601,446
November 1, 2019 - November 30, 2019	—	\$ —	—	\$ 25,601,446
December 1, 2019 - December 31, 2019	—	\$ —	—	\$ 25,601,446
Total for quarter ended December 31, 2019	—	—	—	—

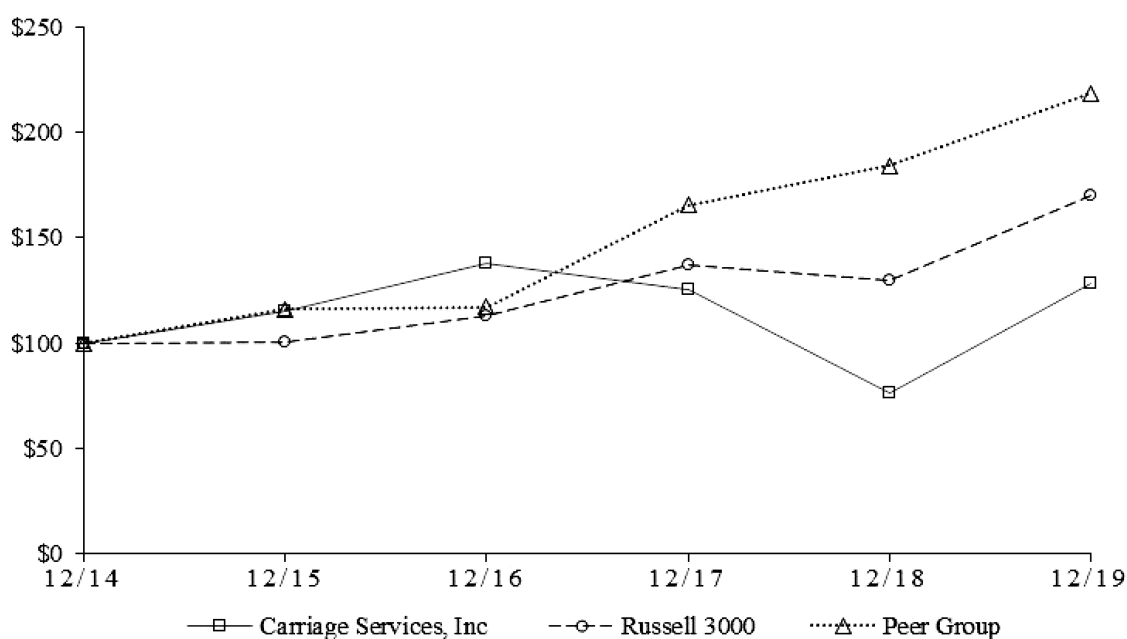
(1) See the first paragraph under the caption “– Purchases of Equity Securities by the Issuer” for more information on our publicly announced share repurchase program.

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 2014, 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



	12/14	12/15	12/16	12/17	12/18	12/19
Carriage Services, Inc.	\$ 100.00	\$ 115.53	\$ 138.18	\$ 125.14	\$ 76.46	\$ 128.08
Russell 3000	100.00	100.47	113.26	137.17	129.98	170.28
Peer Group	100.00	116.01	117.18	165.56	184.01	218.67

(1) Fiscal year ending December 31. \$100 invested on December 31, 2014 in stock or index, including reinvestment of dividends. Peer Group above includes SCI and StoneMor. Park Lawn is publicly listed on the Toronto Stock Exchange, which is quoted in Canadian Dollars and is excluded from the graph above. 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, 2015, 2016, 2017, 2018 and 2019. These historical results are not indicative of our future performance.

This historical financial data should be read together with the “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.

	Years ended December 31,				
	2015	2016	2017	2018	2019
	(dollars in thousands, except per share amounts)				
INCOME STATEMENT DATA:					
Revenue	\$ 242,502	\$ 248,200	\$ 258,139	\$ 267,992	\$ 274,107
Gross profit	77,508	79,650	76,799	75,947	79,585
Operating income	48,648	50,204	48,941	43,307	52,289
Income before income taxes	34,590	32,241	32,782	18,266	22,416
Net income attributable to common shareholders	20,853	19,581	37,193	11,645	14,533
Basic earnings per common share	\$ 1.16	\$ 1.18	\$ 2.25	\$ 0.64	\$ 0.81
Diluted earnings per common share	\$ 1.12	\$ 1.12	\$ 2.09	\$ 0.63	\$ 0.80
Dividends declared per common share	\$ 0.100	\$ 0.150	\$ 0.225	\$ 0.300	\$ 0.300
Weighted average number of common and common equivalent shares outstanding:					
Basic	17,791	16,515	16,438	17,971	17,877
Diluted	18,317	17,460	17,715	18,374	18,005
BALANCE SHEET DATA:					
Total assets	\$ 833,139	\$ 885,069	\$ 921,533	\$ 917,502	\$ 1,129,755
Long-term debt and credit facility, net of current maturities	195,009	204,404	212,154	33,070	87,840
Convertible subordinated notes due 2021	115,227	119,596	124,441	5,732	5,971
Senior notes due 2026	—	—	—	319,108	395,447
Stockholders' equity	157,594	175,734	197,656	221,492	226,569

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, 2019, we operated 186 funeral homes in 29 states and 31 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 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, 2019.

During 2020, we intend to focus on integrating our newly acquired businesses and to use cash on hand and borrowings under our Credit Facility primarily 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 Credit Facility) to repurchase shares of our common stock and our remaining 2.75% convertible subordinated notes due 2021 (“Convertible Notes”) in open market or privately-negotiated transactions. We have the ability to draw on our 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.

Cash Flows

We began 2019 with \$0.6 million in cash and other liquid investments and ended the year with \$0.7 million in cash. At December 31, 2019, we had borrowings of \$83.8 million outstanding on our Credit Facility compared to \$27.1 million as of December 31, 2018 and \$92.0 million as of December 31, 2017.

The following table sets forth the elements of cash flow for the years ended December 31, 2017, 2018 and 2019 (in thousands):

	<u>2017</u>	<u>2018</u>	<u>2019</u>
Cash at beginning of year	\$ 3,286	\$ 952	\$ 644
Cash flow from operating activities	45,230	48,994	43,216
Acquisitions and land for new construction	(28,799)	(37,970)	(140,907)
Deposit on pending acquisition	—	—	(5,000)
Proceeds from insurance reimbursements	—	—	1,433
Net proceeds from the sale of businesses and other assets	5,731	—	967
Growth capital expenditures	(7,973)	(4,260)	(6,584)
Maintenance capital expenditures	(8,422)	(9,266)	(8,795)
Cash flow from investing activities	<u>(39,463)</u>	<u>(51,496)</u>	<u>(158,886)</u>
Net borrowings (payments) on long-term debt obligations	11,088	(194,340)	54,413
Payment of debt issuance costs related to long-term debt	—	(1,751)	(891)
Acquisition of Convertible Notes	—	(98,266)	(27)
Transaction costs related to the acquisition of Convertible Notes	—	(885)	—
Proceeds from the issuance of the Senior Notes	—	320,125	76,688
Payment of debt issuance costs related to the Senior Notes	—	(1,367)	(980)
Dividends paid on common stock	(3,709)	(5,513)	(5,398)
Net proceeds from employee equity plans	987	595	1,251
Purchase of treasury stock	(16,366)	(16,266)	(9,152)
Other financing costs	(101)	(138)	(162)
Cash flow from financing activities	<u>(8,101)</u>	<u>2,194</u>	<u>115,742</u>
Cash at end of year	<u>\$ 952</u>	<u>\$ 644</u>	<u>\$ 716</u>

Operating Activities

For the year ended December 31, 2019, cash provided by operating activities was \$43.2 million compared to \$49.0 million for the year ended December 31, 2018 and \$45.2 million for the year ended December 31, 2017. The decrease of \$5.8 million for the year ended December 31, 2019 compared to the year ended December 31, 2018 was due primarily to approximately \$5.0 million in more cash interest paid in 2019 compared to 2018, as well as additional unfavorable working capital changes.

The increase of \$3.8 million for the year ended December 31, 2018 compared to the year ended December 31, 2017 was primarily due to the favorable impact of working capital changes.

Investing Activities

Our investing activities resulted in a net cash outflow of \$158.9 million for the year ended December 31, 2019 compared to \$51.5 million for the year ended December 31, 2018 and \$39.5 million for the year ended December 31, 2017, an increase of \$107.4 million and \$12.0 million, respectively.

During the year ended December 31, 2019, we acquired, in three separate transactions, two funeral home and cemetery combination businesses, seven funeral home businesses and three ancillary service businesses for an aggregate purchase price of \$140.9 million. In October 2019, we acquired the following: (i) four funeral home businesses in Buffalo, New York; and (ii) one funeral home and cemetery combination business, three funeral home businesses and three ancillary service businesses, which consist of a flower shop, a pet cremation business and an online cremation business in the Dallas, Texas area. In December 2019, we acquired one funeral home and cemetery combination business in Fairfax, Virginia.

During the year ended December 31, 2019, we paid a \$5.0 million deposit for a funeral home and cemetery combination business that we acquired in January 2020.

During the year ended December 31, 2019, we received proceeds of \$1.4 million from our property insurance policy for the reimbursement of renovation costs for our funeral and cemetery businesses that were damaged by Hurricane Michael.

During the year ended December 31, 2019, we sold a funeral home business for \$0.9 million and we sold real property for \$0.1 million related to a funeral home we merged with another business in an existing market.

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 the aggregate purchase price of \$27.5 million. We also purchased real estate for a funeral home parking lot expansion projects for \$1.3 million. Additionally, we sold a funeral home business for \$0.6 million and land for \$5.1 million.

For the year ended December 31, 2019, capital expenditures totaled \$15.4 million compared to \$13.5 million for the year ended December 31, 2018, and \$16.4 million for the year ended December 31, 2017, an increase of \$1.9 million and a decrease of \$2.9 million, respectively.

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

	<u>2017</u>	<u>2018</u>	<u>2019</u>
<i>Growth</i>			
Cemetery development	\$ 3,688	\$ 3,149	\$ 4,348
Construction for new funeral facilities	3,117	11	—
Renovations at certain businesses ⁽¹⁾	1,168	1,100	2,236
Total Growth	<u>\$ 7,973</u>	<u>\$ 4,260</u>	<u>\$ 6,584</u>

(1) During the year ended December 31, 2019, we spent \$1.6 million for renovations on four businesses that were affected by Hurricane Michael, of which \$1.4 million was reimbursed by our property insurance policy.

	<u>2017</u>	<u>2018</u>	<u>2019</u>
<i>Maintenance</i>			
Facility repairs and improvements	\$ 2,239	\$ 2,591	\$ 1,820
General equipment and furniture	2,010	2,247	3,032
Vehicles	1,928	2,556	1,950
Paving roads and parking lots	1,287	674	795
Information technology infrastructure improvements	915	1,172	977
Other	43	26	221
Total Maintenance	<u>\$ 8,422</u>	<u>\$ 9,266</u>	<u>\$ 8,795</u>

Financing Activities

Our financing activities resulted in a net cash inflow of \$115.7 million for the year ended December 31, 2019 compared to \$2.2 million for the year ended December 31, 2018 and net cash outflow of \$8.1 million for the year ended December 31, 2017, an increase of \$113.5 million and \$10.3 million, respectively.

For the year ended December 31, 2019, we had net proceeds related to the issuance of our Additional Senior Notes of \$75.7 million and net borrowing on our long-term debt obligations of \$53.5 million. We purchased treasury stock for \$9.2 million and paid \$5.4 million in dividends on our common stock.

For the year ended December 31, 2018, we had net proceeds related to the issuance of our Initial 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.

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, 2019, 2018 and 2017, our Board declared the following dividends payable on the dates below (in thousands, except per share amounts):

<u>2019</u>	<u>Per Share</u>	<u>Dollar Value</u>
March 1st	\$ 0.075	\$ 1,360
June 1st	\$ 0.075	\$ 1,365
September 1st	\$ 0.075	\$ 1,336
December 1st	\$ 0.075	\$ 1,337

<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	\$ 1,430

<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

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 Exchange Act. On October 25, 2017, our Board approved a \$15.0 million increase in its authorization for repurchases bringing the total authorized repurchase amount to \$40.0 million. On July 31, 2019, our Board approved an additional \$25.0 million for repurchases of our common stock in accordance with the Exchange Act.

During the year ended December 31, 2019, we repurchased 400,000 shares of common stock for a total cost of \$7.8 million at an average cost of \$19.39 per share pursuant to our 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. 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. 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, 2019, we had approximately \$25.6 million available for repurchase under our share repurchase program.

Long-term Debt and Lease Obligations

The outstanding principal of our long-term debt and lease obligations at December 31, 2018 and 2019 is as follows (in thousands):

	<u>December 31, 2018</u>	<u>December 31, 2019</u>
Credit Facility	\$ 27,100	\$ 83,800
Finance leases	6,143	5,854
Operating leases	—	21,533
Acquisition debt	6,925	5,658
Total long-term debt and lease obligations	<u>\$ 40,168</u>	<u>\$ 116,845</u>

Credit Facility

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

We used \$291.4 million of the net proceeds from the sale of the Initial Senior Notes to repay all amounts outstanding under our former credit agreement. 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 senior secured revolving credit facility (as defined below).

On May 31, 2018, we entered into a \$150.0 million senior secured revolving credit facility with the financial institutions party thereto, as lenders, and Bank of America, N.A., as administrative agent, which we subsequently amend in November 2018 and July 2019.

For the year ended December 31, 2018, we recognized a loss of \$1.6 million, recorded in *Net loss on early extinguishment of debt*, related to the termination of our former credit agreement, which consisted of a write-off of \$0.7 million of transaction costs and a write-off of \$0.9 million of unamortized debt issuance costs. Additionally, we incurred \$1.1 million in transaction costs related to our senior secured revolving credit facility, which were capitalized and will be amortized over the remaining term of the related debt using the straight-line method.

On December 19, 2019, we entered into a third amendment and commitment increase (“Credit Facility”) to our \$150.0 million senior secured revolving credit facility with the financial institutions party thereto, as lenders, and Bank of America, N.A., as administrative agent (in such capacity, the “Administrative Agent”) to increase our commitment to \$190.0 million. The Credit Facility is comprised of:

(i) a \$190.0 million revolving credit facility, which includes a \$15.0 million subfacility for letters of credit and a \$10.0 million swingline, and

(ii) an accordion or incremental option allowing for future increases in the facility size by an additional amount of up to \$75.0 million in the form of increased revolving commitments or incremental term loans.

The final maturity of the Credit Facility will occur on May 31, 2023.

For the year ended December 31, 2019, we incurred \$0.9 million in transactions costs related to our Credit Facility, which were capitalized and will be amortized over the remaining term of the related debt using the straight-line method.

The Company’s obligations under the Credit Facility are unconditionally guaranteed on a joint and several basis by the same subsidiaries which guarantee the Senior Notes and certain of the Company’s Credit Facility Guarantors.

The Credit Facility is secured by a first-priority perfected security interest in and lien on substantially all of the Company’s personal property assets and those of the Credit Facility Guarantors. In the event the Company’s actual Total Leverage Ratio is not at least 0.25 less than the required Total Leverage Ratio covenant level, at the discretion of the Administrative Agent, the Administrative Agent may unilaterally compel the Company and the Credit Facility Guarantors to grant and perfect first-priority mortgage liens on fee-owned real property assets which account for no less than 50% of funeral operations EBITDA.

The 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 the Company’s business and the maintenance of existing rights and privileges, the maintenance of property and insurance, amongst others.

In addition, the Credit Facility also contains customary negative covenants, including, but not limited to, covenants that restrict (subject to certain exceptions) the ability of the Company and the Credit Facility Guarantors to incur indebtedness, grant liens, make investments, engage in acquisitions, mergers or consolidations, and pay dividends and other restricted payments, and the following financial maintenance covenants: (A) a Total Leverage Ratio not to exceed (i) 6.00 to 1.00 for the quarter ended December 31, 2019, (ii) 5.75 to 1.00 for the quarters ended March 31, 2020, June 30, 2020 and September 30, 2020 and (iii) 5.50 to 1.00 for the quarter ended December 31, 2020 and each quarter ended thereafter, (B) a Senior Secured Leverage Ratio (as defined in the Credit Facility) not to exceed 2.00 to 1.00 as of the end of any period of four consecutive fiscal quarters, and (C) a Fixed Charge Coverage Ratio (as defined in the Credit Facility) of not less than 1.20 to 1.00 as of the end of any period of four consecutive fiscal quarters. Effective with the Credit Facility, an applicable rate premium shall be set forth in reference to the Total Leverage Ratio and increases by 0.500% whenever the most recent compliance certificate delivered indicates that the Total Leverage Ratio is greater than 5.00 to 1.00. The financial maintenance covenants will be calculated for the Company and its subsidiaries on a consolidated basis.

As of December 31, 2019, we had outstanding borrowings under our Credit Facility of \$83.8 million. We had one letter of credit issued on November 25, 2019 and outstanding under the Credit Facility for approximately \$2.0 million, which bears interest at 2.125% and will expire on November 25, 2020. The letter of credit automatically renews annually and secures our obligations under our various self-insured policies. Outstanding borrowings under our 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, 2019, the prime rate margin was

equivalent to 1.500% and the LIBOR rate margin was 2.500%. The weighted average interest rate on our Credit Facility for the years ended December 31, 2018 and 2019 was 4.0% and 2.9%, respectively.

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 Credit Facility. Additionally, we do not currently have any significant restrictions on our ability to receive dividends or loans from any Credit Facility Guarantors.

We are in compliance with the covenants contained in our Credit Facility as of December 31, 2019, with a leverage ratio of 5.66 to 1.00, a fixed charge coverage ratio of 2.70 to 1.00 and a senior secured leverage ratio of 0.94 to 1.00.

Interest expense related to our Credit Facility was \$6.9 million, \$4.3 million and \$1.6 million for the years ended December 31, 2017, 2018 and 2019, respectively. Amortization of debt issuance costs related to our Credit Facility was \$0.3 million, \$0.2 million and \$0.2 million for the years ended December 31, 2017, 2018 and 2019, respectively.

Lease Obligations

On January 1, 2019, we adopted Topic 842 using the modified retrospective method for all lease arrangements at the beginning of the period of adoption. As a result, we recorded operating lease right-of-use (“ROU”) assets of \$16.5 million and operating lease liabilities of \$17.3 million related to real estate and equipment leases, based on the present value of the future lease payments on the date of adoption. Lease expense related to our operating leases and short-term leases was \$3.7 million and \$0.3 million, respectively for the year ended December 31, 2019. Depreciation expense related to our finance leases was \$0.5 million for the year ended December 31, 2019. Interest expense related to our finance leases was \$0.5 million for the year ended December 31, 2019.

During the year ended December 31, 2019, we modified an existing operating lease to extend the term through 2030. As a result of this modification, we increased our lease liabilities and right-of-use assets by \$8.2 million.

Acquisition Debt

Acquisition debt consists of deferred purchase price and promissory notes payable to sellers. A majority of the deferred purchase price and notes bear no interest 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 \$0.9 million, \$0.8 million and \$0.6 million for the years ended December 31, 2017, 2018 and 2019, 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 (the “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”).

On December 24, 2018, we completed privately-negotiated repurchases of an additional \$22.4 million in aggregate principal amount of Convertible Notes for \$22.9 million in cash (plus accrued interest of approximately \$0.2 million totaling \$23.0 million). Following the Exchange and the December 2018 repurchases, the aggregate principal amount of our Convertible Notes outstanding was reduced to \$6.3 million.

For the year ended December 31, 2018, we recognized a net gain of \$1.7 million, recorded in *Net loss on early extinguishment of debt*, related to the Exchange and December 2018 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.

We incurred \$0.9 million in transactions costs related to the Exchange and December 2018 repurchases 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*.

On April 4, 2019, we completed a privately-negotiated repurchase of an additional \$25,000 in aggregate principal amount of Convertible Notes then outstanding for \$27,163.

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 2018, 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, 2019, the adjusted conversion rate of the Convertible Notes is 45.4615 shares of our common stock per \$1,000 principal amount of Convertible Notes, equivalent to an adjusted conversion price of \$22.00 per share of common stock.

At December 31, 2019, 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 \$6.0 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 14 months of the Convertible Notes. The effective interest rate on the unamortized debt discount for the years ended December 31, 2018 and 2019 was 11.3% and 11.4%, respectively. The effective interest rate on the debt issuance costs for both years ended December 31, 2018 and 2019 was 3.2%.

Interest expense on the Convertible Notes included contractual coupon interest expense of \$4.0 million, \$1.9 million and \$0.2 million for the years ended December 31, 2017, 2018 and 2019, respectively. Accretion of the discount on the Convertible Notes was \$4.3 million, \$2.2 million and \$0.2 million for the years ended December 31, 2017, 2018 and 2019, respectively. Amortization of debt issuance costs related to our Convertible Notes was \$517,000, \$245,000 and \$24,000 for the years ended December 31, 2017, 2018 and 2019, respectively.

Senior Notes

On May 31, 2018, we issued \$325.0 million in aggregate principal amount of our Initial 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. We incurred \$1.4 million in debt issuance costs related to the Initial Senior Notes.

The Initial 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.

On December 19, 2019, we issued an additional \$75.0 million in aggregate principal amount of our Initial Senior Notes (the “Additional Senior Notes” and, together with the Initial Senior Notes, the “Senior Notes”) and related guarantees by the Subsidiary Guarantors in a private offering under Rule 144A and Regulation S of the Securities Act. The Additional Senior Notes were issued as additional securities under the Indenture.

We received proceeds of \$76.9 million, net of a debt premium of \$1.7 million (plus accrued interest of \$0.2 million). We incurred \$1.0 million in debt issuance costs related to the Additional Senior Notes. The additional issuance brings the total principal amount of Senior Notes outstanding to \$400.0 million. The Senior Notes are treated as a single class of securities under the Indenture, and the Additional Senior Notes have identical terms to the Initial Senior Notes, except with respect to the date of issuance, the issue price, the initial interest accrual date and the initial interest payment date.

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 with respect to the Initial Senior Notes and June 1, 2020 with respect to the Additional Senior Notes 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.

At December 31, 2019, the debt discount of \$4.1 million, the debt premium of \$1.7 million and the debt issuance costs of \$2.1 million are being amortized using the effective interest method over the remaining term of approximately 77 months of the Senior Notes.

The effective interest rate on the unamortized debt discount and the unamortized debt issuance costs for the Initial Senior Notes for the year ended December 31, 2019 was 6.87% and 6.69%, respectively. The effective interest rate on the unamortized debt premium and the unamortized debt issuance costs for the Additional Senior Notes for the year ended December 31, 2019 was 6.20% and 6.88%, respectively.

Interest expense on the Senior Notes included contractual coupon interest expense of \$12.6 million and \$21.7 million for the years ended December 31, 2018 and 2019, respectively. Amortization of the debt discount on the Senior Notes was \$0.3 million and \$0.5 million for the years ended December 31, 2018 and 2019, respectively and amortization of debt issuance costs on the Senior Notes was \$0.1 million for both the years ended December 31, 2018 and 2019.

CONTRACTUAL OBLIGATIONS

The following table summarizes the known future payments required for the debt on our Consolidated Balance Sheet as of December 31, 2019. 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 thousands)						
		Total	2020	2021	2022	2023	2024	After 5 Years
Long-term debt obligations	14	\$ 90,764	\$ 1,289	\$ 1,023	\$ 523	\$ 84,363	\$ 550	\$ 3,016
Interest obligation on long-term debt ^(a)	14	15,511	4,138	4,074	4,014	1,826	252	1,207
Finance lease obligations, including interest	17	10,466	828	836	860	860	791	6,291
Senior Notes ^(b)	16	400,000	—	—	—	—	—	400,000
Convertible Notes ^(c)	15	6,319	—	6,319	—	—	—	—
Interest on Senior Notes	16	170,042	26,500	26,500	26,500	26,500	26,500	37,542
Interest on Convertible Notes	15	210	174	36	—	—	—	—
Operating lease obligations, including interest	17	34,703	3,358	3,705	3,345	3,249	3,248	17,798
Total contractual obligations		\$728,015	\$36,287	\$42,493	\$35,242	\$116,798	\$31,341	\$ 465,854

(a) Based on interest rates in effect at December 31, 2019.

(b) Matures June 1, 2026.

(c) Matures March 15, 2021.

OFF-BALANCE SHEET ARRANGEMENTS

The following table summarizes our off-balance sheet arrangements as of December 31, 2019. 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 our executive officers and certain 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 thousands)						
		Total	2020	2021	2022	2023	2024	After 5 Years
Non-compete agreements	18	\$ 8,090	\$ 2,135	\$ 1,905	\$ 1,465	\$ 993	\$ 665	\$ 927
Consulting agreements	18	2,118	869	663	404	162	20	—
Employment agreements ^(a)	18	11,466	3,482	3,482	3,077	777	648	—
Total contractual cash obligations		<u>\$21,674</u>	<u>\$ 6,486</u>	<u>\$ 6,050</u>	<u>\$ 4,946</u>	<u>\$1,932</u>	<u>\$1,333</u>	<u>\$ 927</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 Credit Facility, both of which may be more difficult to access.

FINANCIAL HIGHLIGHTS

Below are our financial highlights for the years ended December 31, 2017, 2018 and 2019 (in thousands except for volumes and averages):

	Years Ended December 31,		
	2017	2018	2019
Revenue	\$ 258,139	\$ 267,992	\$ 274,107
Funeral contracts	34,894	36,816	38,940
Average revenue per contract	\$ 5,705	\$ 5,674	\$ 5,499
Preneed interment rights (property) sold	6,959	7,063	7,205
Average price per interment right sold	\$ 3,294	\$ 3,472	\$ 3,653
Gross profit	\$ 76,799	\$ 75,947	\$ 79,585
Net income	\$ 37,193	\$ 11,645	\$ 14,533

Revenue in 2019 increased \$6.1 million compared to 2018, as we experienced a 5.8% increase in total funeral contracts, offset by a decrease in the average revenue per funeral contract of 3.1%. In addition, the average price per interment right (property) sold increased 5.2% and we experienced an increase of 2.0% in the number of preneed interment rights sold.

Revenue in 2018 increased \$9.9 million 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. Further discussion of Revenue for our funeral home and cemetery segments is presented herein under “– Results of Operations.”

Gross profit in 2019 increased \$3.6 million compared to 2018, primarily due to an increase in revenue from our funeral home segment due to the acquisitions made in the fourth quarter of 2019 and the second half of 2018.

Gross profit in 2018 decreased \$0.9 million 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. 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 2019 increased \$2.9 million compared to 2018 primarily due to the increase in gross profit, as well as a \$5.0 million decrease in general and administrative expenses, offset by a \$2.5 million increase in interest expense primarily related to our Senior Notes and a \$2.9 million increase in the loss on divested businesses.

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.

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, 2019 dated February 19, 2020 and discussed in the corresponding earnings conference call. This Trend Report is used as a supplemental financial 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, 2017, 2018, and 2019 (in thousands):

	<u>2017</u>	<u>2018</u>	<u>2019</u>
Net income	\$ 37,193	\$ 11,645	\$ 14,533
Special items, net of tax except for items noted by**(1)			
Acquisition and divestiture expenses	—	—	1,646
Severance and retirement costs	—	1,134	951
Performance awards cancellation write-off	—	2,594	—
Accretion of discount on Convertible Notes**	4,329	2,192	241
Net loss on early extinguishment of debt	—	397	—
Loss on sale of business and other costs	—	439	3,331
Goodwill and other impairments	—	805	761
Litigation reserve	—	790	592
Natural disaster costs	403	345	—
Tax expense related to divested business**	—	—	911
Gain on insurance proceeds	—	—	(699)
Other special items	—	—	265
Tax adjustment related to certain discrete items**	(17,176)	1,225	—
Adjusted net income ⁽²⁾	<u>\$ 24,749</u>	<u>\$ 21,566</u>	<u>\$ 22,532</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 the year ended December 31, 2017 and 21 percent for the years ended December 31, 2018 and 2019, except for the Accretion of the discount on the Convertible Notes, the Tax expense related to divested business 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, 2017, 2018, and 2019 (in thousands):

	<u>2017</u>	<u>2018</u>	<u>2019</u>
Gross profit	\$ 76,799	\$ 75,947	\$ 79,585
Cemetery property amortization	3,350	3,602	3,985
Field depreciation expense	11,024	12,015	12,370
Regional and unallocated funeral and cemetery costs	13,339	12,749	13,827
Operating profit ⁽¹⁾	<u>\$ 104,512</u>	<u>\$ 104,313</u>	<u>\$ 109,767</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, 2017, 2018, and 2019 (in thousands):

	<u>2017</u>	<u>2018</u>	<u>2019</u>
Funeral Home	\$ 81,981	\$ 82,154	\$ 85,737
Cemetery	22,531	22,159	24,030
Operating profit	<u>\$ 104,512</u>	<u>\$ 104,313</u>	<u>\$ 109,767</u>
Operating profit margin ⁽¹⁾	40.5%	38.9%	40.0%

(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, 2019 COMPARED TO YEAR ENDED DECEMBER 31, 2018

Results of Operations

The following is a discussion of our results of operations for the years ended December 31, 2019 and 2018.

The term “same store” refers to funeral homes and cemeteries acquired prior to January 1, 2015 and owned and operated for the entirety of each period being presented, excluding certain funeral home businesses that we intend to divest in the near future.

The term “acquired” refers to funeral homes and cemeteries purchased after December 31, 2014, excluding any funeral home businesses that we intend to divest in the near future. 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 the three funeral home businesses whose building leases expired, one funeral home business we sold and a funeral home business we merged with a business in an existing market in 2019. The term “divested” when discussed in the Cemetery Segment, refers to three cemetery businesses that we divested as a result of a management agreement that expired on September 30, 2018.

“Planned divested” in the Funeral Home Segment refers to the funeral home businesses that we intend to divest in the near future.

“Ancillary” in the Funeral Home Segment represents our flower shop, pet cremation business and online cremation business.

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, 2019 compared to the year ended December 31, 2018 (in thousands):

	Years Ended December 31,	
	2018	2019
Revenue:		
Same store operating revenue	\$ 166,934	\$ 167,246
Acquired operating revenue	26,835	33,146
Divested/planned divested revenue	8,399	7,195
Ancillary funeral services revenue	—	748
Preneed funeral insurance commissions	1,294	1,475
Preneed funeral trust and insurance	7,263	7,058
Total	<u>\$ 210,725</u>	<u>\$ 216,868</u>
Operating profit:		
Same store operating profit	\$ 63,119	\$ 63,938
Acquired operating profit	9,732	12,547
Divested/planned divested operating profit	1,779	1,437
Ancillary funeral services operating profit	—	298
Preneed funeral insurance commissions	414	633
Preneed funeral trust and insurance	7,110	6,884
Total	<u>\$ 82,154</u>	<u>\$ 85,737</u>

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

	Years Ended December 31,	
	2018	2019
Same store:		
Contract volume	30,838	31,544
Average revenue per contract, excluding preneed funeral trust earnings	\$ 5,413	\$ 5,302
Average revenue per contract, including preneed funeral trust earnings	\$ 5,620	\$ 5,493
Burial rate	39.5%	38.2%
Cremation rate	52.8%	54.1%
Acquired:		
Contract volume	3,854	5,482
Average revenue per contract, excluding preneed funeral trust earnings	\$ 6,963	\$ 6,046
Average revenue per contract, including preneed funeral trust earnings	\$ 7,057	\$ 6,144
Burial rate	49.3%	44.7%
Cremation rate	42.6%	48.1%

Funeral home same store operating revenue for the year ended December 31, 2019 increased \$0.3 million, primarily due to the increase in same store contract volume, offset by the decrease in the average revenue per contract compared to year ended December 31, 2018. In spite of the high contract volume we had in the first quarter of 2018 due to a severe flu season, we experienced a 2.3% increase in contract volume in the twelve months ended December 31, 2019 compared to the same period in 2018, primarily due to the revision of our funeral home standards operating model to emphasize our focus on growing operating revenue and serving more families.

Same store operating profit for the year ended December 31, 2019 increased \$0.8 million when compared to the year ended December 31, 2018 and the comparable operating profit margin increased 40 basis points to 38.2%. Operating expenses decreased

\$0.5 million primarily due to a decrease in salaries and benefits of \$0.8 million, or 0.5% as a percentage of operating revenue, offset by a \$0.2 million increase in promotional costs, or 0.1% as a percentage of operating revenue. This is a result of changes implemented in the fourth quarter in 2018, which included assessing leadership and support teams at each business to ensure an optimal personnel mix, improving social media presence and reviewing pricing on merchandise and services to maximize operational efficiencies.

Funeral home acquired operating revenue for the year ended December 31, 2019 increased \$6.3 million, as our funeral home acquired portfolio for the year ended December 31, 2019 included four businesses acquired in the third quarter of 2018, and nine businesses in the fourth quarter of 2019 not fully present in the year ended December 31, 2018. Although we experienced an increase in acquired contract volumes, we experienced decreases in acquired average revenue per burial and cremation contracts due to increased discounts.

Acquired operating profit for the year ended December 31, 2019 increased \$2.8 million when compared to the year ended December 31, 2018. Operating profit margin increased by 160 basis points to 37.9% for the year ended December 31, 2019 compared to the same period in 2018. The increase is primarily due to the increase in acquired revenue and better management of expenses as operating expenses increased \$3.5 million for the comparable period. We experienced significant savings in salaries and benefits which decreased 2.2% as a percentage of operating revenue, as a result of changes implemented in the fourth quarter of 2018 described above.

Ancillary funeral services revenue, which is recorded in *Other revenue*, represents revenue from our flower shop, pet cremation business and online cremation business, which was acquired in the fourth quarter of 2019. Preneed funeral insurance and preneed funeral trust earnings, also recorded in *Other revenue*, on a combined basis, remained flat for the year ended December 31, 2019 compared to the same period in 2018.

Operating profit from our ancillary funeral service businesses was \$0.3 million for the year ended December 31, 2019, with an operating profit margin of 39.8%. Operating profit for preneed funeral insurance commission and preneed trust earnings, on a combined basis, also remained flat for the same comparative period primarily due to the increase in funeral commission revenue, offset by the decrease in preneed trust earnings.

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, 2018 compared to the year ended December 31, 2019 (in thousands):

	Years Ended December 31,	
	2018	2019
Revenue:		
Same store operating revenue	\$ 45,135	\$ 49,455
Acquired operating revenue	—	295
Divested revenue	4,712	—
Preneed cemetery trust and insurance	5,761	6,035
Preneed cemetery finance charges	1,659	1,454
Total	<u>\$ 57,267</u>	<u>\$ 57,239</u>
Operating profit:		
Same store operating profit	\$ 13,880	\$ 17,055
Acquired operating profit	—	73
Divested operating profit	1,376	—
Preneed cemetery trust and insurance	5,244	5,448
Preneed cemetery finance charges	1,659	1,454
Total	<u>\$ 22,159</u>	<u>\$ 24,030</u>

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

	<u>Years Ended December 31,</u>	
	<u>2018</u>	<u>2019</u>
Same store:		
Preneed revenue as a percentage of operating revenue	58%	61%
Preneed revenue (in thousands)	\$ 26,407	\$ 30,204
Number of preneed interment rights sold	6,475	7,145
Atneed revenue (in thousands)	\$ 18,727	\$ 19,251
Acquired:		
Preneed revenue as a percentage of operating revenue	—%	65%
Preneed revenue (in thousands)	\$ —	\$ 192
Number of preneed interment rights sold	—	60
Atneed revenue (in thousands)	\$ —	\$ 103

Cemetery same store operating revenue for the year ended December 31, 2019 increased \$4.3 million, as we experienced a 10.3% increase in the number of preneed interment rights sold and a 2.9% increase in the average price of interments sold for the year ended December 31, 2019 compared to the same period in 2018. Same store atneed revenue, which represents approximately 39% of our same store operating revenue increased \$0.5 million, as we experienced a 4.0% increase in the average sale per contract, offset by a 1.2% decrease in the number of atneed contracts sold.

Cemetery same store operating profit for the year ended December 31, 2019 increased \$3.2 million from the same period in 2018. The comparable operating profit margin increased 370 basis points to 34.5% for the year ended December 31, 2019 from 30.8% in the same period in 2018. The improvement in operating profit margin is a result of changes implemented in the fourth quarter of 2018 and continuing in the first half of 2019, which included a larger focus on the growth of revenue and market share, the hiring of talented sales managers for our larger cemeteries, and the investment in new product inventory for sale. As a result, we gained significant operational efficiencies throughout 2019, as same store cemetery operating costs only increased 4.0% compared to the 9.6% increase in operating revenue.

Our acquired cemetery portfolio includes two businesses acquired during the fourth quarter of 2019. These two businesses contributed \$0.3 million in revenue and \$0.1 million in operating profit for the year ended December 31, 2019.

Preneed cemetery trust earnings and preneed cemetery finance charges, which are recorded in *Other revenue*, on a combined basis, increased \$0.1 million for the year ended December 31, 2019 compared to the same period in 2018. The increase is due to a \$0.3 million increase in realized capital gains in our perpetual care trust funds in 2019 compared to 2018, partially offset by a \$0.2 million decrease in finance charge revenue for the same comparable period. The decrease in finance charge revenue is due to our enhanced preneed cemetery property sales strategy of reducing interest rates on preneed contracts which has led to the increase in our cemetery same store operating revenue in 2019. Operating profit for the two categories of *Other revenue*, on a combined basis, remained flat for the same comparative period.

Cemetery property amortization. Cemetery property amortization totaled \$4.0 million for the year ended December 31, 2019, an increase of \$0.4 million compared to the year ended December 31, 2018. The increase was primarily attributable to additional sales of cemetery property in 2019 compared to 2018.

Field depreciation. Depreciation expense for our field businesses totaled \$12.4 million for the year ended December 31, 2019, an increase of \$0.4 million compared to the year ended December 31, 2018. The increase was primarily attributable to additional depreciation expense from the assets acquired through our 2018 and 2019 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 \$13.8 million for the year ended December 31, 2019, an increase of \$1.1 million primarily due to an increase of \$0.9 million in severance expense from the separation of certain operational leadership, \$0.3 million increase in benefits provided to employees and a \$0.5 million increase in incentive compensation, offset by a decrease of \$0.5 million in natural disaster costs and a decrease of \$0.1 million in other general administrative costs.

Other Financial Statement Items

General, administrative and other. General, administrative and other expenses totaled \$25.9 million for the year ended December 31, 2019, a decrease of \$4.9 million compared to the year ended December 31, 2018. The decrease was attributable to the following: (1) a \$4.4 million decrease in incentive and equity compensation primarily related to the cancellation of performance awards in 2018; (2) a \$1.1 million decrease in severance costs and a \$1.1 million decrease in salaries and benefits related to the separation of executive operating leadership in 2018; (3) an \$0.8 million decrease in litigation reserves related to the payment of a class action settlement agreement in the fourth quarter of 2019; and (4) a \$0.4 million decrease in group health insurance, offset by (5) a \$2.1 million increase in acquisition costs; and (6) an \$0.8 million increase in other general administrative costs.

Home office depreciation and amortization. Home office depreciation and amortization expense totaled \$1.4 million for the year ended December 31, 2019, a decrease of \$0.4 million compared to the year ended December 31, 2018. The decrease was primarily attributable to machinery and equipment at the home office becoming fully depreciated in the first quarter of 2019.

Interest expense. Interest expense related to its respective debt arrangement for the years ended December 31, 2018 and 2019 is as follows (in thousands):

	Years Ended December 31,	
	2018	2019
Senior Notes	\$ 12,969	\$ 22,343
Credit Facility	4,585	1,830
Convertible Notes	2,123	198
Finance leases	530	520
Acquisition debt	791	622
Miscellaneous	111	9
Total	<u>\$ 21,109</u>	<u>\$ 25,522</u>

Accretion of discount on convertible subordinated notes. For the year ended December 31, 2019, we recognized accretion of the discount on our Convertible Notes of \$0.2 million compared to \$2.2 million for the same period in 2018, a decrease of \$2.0 million, which was attributable to the Exchange and December 2018 repurchases of our Convertible Notes.

Loss on early extinguishment of debt, net. 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. The components of *Other, net* for the years ended December 31, 2018 and 2019 are as follows (in thousands):

	Years Ended December 31,	
	2018	2019
Loss on sale of business and other assets	\$ (377)	\$ (4,028)
Goodwill impairment	(846)	(742)
Tradenames impairment	—	(221)
Gain on insurance reimbursements	—	885
Other loss	(15)	(4)
Total	<u>\$ (1,238)</u>	<u>\$ (4,110)</u>

Income taxes. Our income tax provision was \$7.9 million for the year ended December 31, 2019 compared to \$6.6 million for the year ended December 31, 2018. Our operating tax rate before discrete items was 33.0% and 31.5% for the years ended December 31, 2019 and 2018, respectively. During the year ended December 31, 2019, we recorded additional tax expense of \$0.9 million related to a divested business previously acquired as a stock acquisition. We also recorded discrete tax expense of

\$0.5 million and \$0.9 million for the years ended December 31, 2019 and 2018, respectively, related primarily to share-based compensation.

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

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. 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 related to revenue.

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 deemed 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. 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 related to revenue.

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. The investments of such trust funds are classified as available-for-sale and are reported at fair market value. 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.

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.

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, 2019, CSV RIA provided these services to approximately 71% 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. 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 related to preneed funeral and cemetery trust funds.

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.

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

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

Goodwill

The excess of the purchase price over the fair value of identifiable net assets of funeral home businesses and cemeteries acquired is recorded as goodwill. 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.

We perform our annual goodwill impairment test as of August 31st each year. 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 conducted qualitative assessments in 2017 and 2018; however, we performed a quantitative assessment in 2019.

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. 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. 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.

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

Intangible Assets

Our intangible assets include tradenames resulting from acquisitions and are included in *Intangible and other non-current assets, net* 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.

We perform our annual intangible assets impairment test as of August 31st each year. 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.

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. In accordance with the guidance, if the fair value of the tradename is less than its carrying amount, then an impairment charge is recorded in an amount equal to the difference.

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

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. 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.

See Part II, Item 8, Financial Statements and Supplementary Data, Notes 7, 11 and 12 for additional information related to fair value measurements.

Income Taxes

We and our subsidiaries file a consolidated U. S. federal income tax return, separate income tax returns in 15 states in which we operate and combined or unitary income tax returns in 14 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.

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

See Part II, Item 8, Financial Statements and Supplementary Data, Note 20 for additional information related to 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 15).

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.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 22 for additional information related to computation of earnings per share.

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, 2019 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, 2019 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 1.67% 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, 2019, we had outstanding borrowings under the Credit Facility of \$83.8 million. Any further borrowings or voluntary prepayments against the 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 Credit Facility at either the prime rate or the LIBOR rate plus a margin. At December 31, 2019, the prime rate margin was equivalent to 1.5% and the LIBOR rate margin was 2.5%. 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 \$0.1 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, 2019, the carrying value of the Convertible Notes on our Consolidated Balance Sheet was \$6.0 million and the fair value of the Convertible Notes was \$7.8 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, 2019, the carrying value of the Senior Notes on our Consolidated Balance Sheet was \$395.4 million and the fair value of the Senior Notes notes was \$426.4 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.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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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 sheets of Carriage Services, Inc. (a Delaware corporation) and subsidiaries (the “Company”) as of December 31, 2018 and 2019, 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, 2019, and the related notes and financial statement schedule included under Item 15(a) (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, 2018 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2019, 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, 2019, 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, 2020 expressed an unqualified opinion.

Change in accounting principle

As discussed in Note 2 to the consolidated financial statements, the Company has changed its method of accounting for leases as of January 1, 2019 due to the adoption of Accounting Standards Codification 842, “Leases”.

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, 2020

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, 2019, 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, 2019, 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, 2019, and our report dated February 28, 2020 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, 2020

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

	December 31,	
	2018	2019
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 644	\$ 716
Accounts receivable, net	18,897	21,478
Inventories	6,751	6,989
Prepaid and other current assets	3,011	10,667
Total current assets	29,303	39,850
Preneed cemetery trust investments	62,432	72,382
Preneed funeral trust investments	82,074	96,335
Preneed cemetery receivables, net	18,441	20,173
Receivables from preneed trusts	17,073	18,024
Property, plant and equipment, net	260,838	279,200
Cemetery property, net	74,958	87,032
Goodwill	303,887	398,292
Intangible and other non-current assets, net	24,425	32,116
Operating lease right-of-use assets	—	22,304
Cemetery perpetual care trust investments	44,071	64,047
Total assets	\$ 917,502	\$ 1,129,755
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 2,015	\$ 1,306
Current portion of finance lease obligations	312	290
Current portion of operating lease obligations	—	1,554
Accounts payable	9,987	8,413
Accrued and other liabilities	22,644	24,026
Total current liabilities	34,958	35,589
Long-term debt, net of current portion	6,925	5,658
Credit facility	26,145	82,182
Convertible subordinated notes due 2021	5,732	5,971
Senior notes due 2026	319,108	395,447
Obligations under finance leases, net of current portion	6,143	5,854
Obligations under operating leases, net of current portion	—	21,533
Deferred preneed cemetery revenue	45,997	46,569
Deferred preneed funeral revenue	28,606	29,145
Deferred tax liability	31,263	41,368
Other long-term liabilities	3,133	1,737
Deferred preneed cemetery receipts held in trust	62,432	72,382
Deferred preneed funeral receipts held in trust	82,074	96,335
Care trusts' corpus	43,494	63,416
Total liabilities	696,010	903,186
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$.01 par value; 80,000,000 shares authorized; 25,703,490 and 25,880,362 issued as of December 31, 2018 and 2019, respectively	257	259
Additional paid-in capital	243,849	242,147
Retained earnings	71,680	86,213
Treasury stock, at cost; 7,625,339 and 8,025,339 shares at December 31, 2018 and 2019, respectively	(94,294)	(102,050)
Total stockholders' equity	221,492	226,569
Total liabilities and stockholders' equity	\$ 917,502	\$ 1,129,755

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)

	Years Ended December 31,		
	2017	2018	2019
Revenue:			
Service revenue	\$ 132,592	\$ 138,604	\$ 142,554
Property and merchandise revenue	108,046	112,253	114,514
Other revenue	17,501	17,135	17,039
	<u>258,139</u>	<u>267,992</u>	<u>274,107</u>
Field costs and expenses:			
Cost of service	66,884	72,123	72,991
Cost of merchandise	85,422	90,008	89,294
Cemetery property amortization	3,350	3,602	3,985
Field depreciation expense	11,024	12,015	12,370
Regional and unallocated funeral and cemetery costs	13,339	12,749	13,827
Other expenses	1,321	1,548	2,055
	<u>181,340</u>	<u>192,045</u>	<u>194,522</u>
Gross profit	76,799	75,947	79,585
Corporate costs and expenses:			
General, administrative and other	26,253	30,827	25,880
Home office depreciation and amortization	1,605	1,813	1,416
	<u>27,858</u>	<u>32,640</u>	<u>27,296</u>
Operating income	48,941	43,307	52,289
Interest expense	(12,948)	(21,109)	(25,522)
Accretion of discount on convertible subordinated notes	(4,329)	(2,192)	(241)
Loss on early extinguishment of debt, net	—	(502)	—
Other, net	1,118	(1,238)	(4,110)
Income before income taxes	32,782	18,266	22,416
Provision for income taxes	(13,100)	(5,754)	(7,395)
Tax adjustment related to certain discrete items	17,511	(867)	(488)
Total benefit (provision) for income taxes	<u>\$ 4,411</u>	<u>\$ (6,621)</u>	<u>\$ (7,883)</u>
Net income	<u>\$ 37,193</u>	<u>\$ 11,645</u>	<u>\$ 14,533</u>
Basic earnings per common share	<u>\$ 2.25</u>	<u>\$ 0.64</u>	<u>\$ 0.81</u>
Diluted earnings per common share	<u>\$ 2.09</u>	<u>\$ 0.63</u>	<u>\$ 0.80</u>
Dividends declared per share	<u>\$ 0.225</u>	<u>\$ 0.300</u>	<u>\$ 0.300</u>
Weighted average number of common and common equivalent shares outstanding:			
Basic	<u>16,438</u>	<u>17,971</u>	<u>17,877</u>
Diluted	<u>17,715</u>	<u>18,374</u>	<u>18,005</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, 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
Net Income – 2019	—	—	—	14,533	—	14,533
Issuance of common stock	81	1	971	—	—	972
Exercise of stock options	76	1	471	—	—	472
Issuance of restricted common stock	26	—	—	—	—	—
Cancellation and retirement of restricted common stock and stock options	(21)	—	(194)	—	—	(194)
Stock-based compensation expense	—	—	2,153	—	—	2,153
Dividends on common stock	—	—	(5,398)	—	—	(5,398)
Treasury stock acquired	(400)	—	—	—	(7,756)	(7,756)
Other	15	—	295	—	—	295
Balance – December 31, 2019	17,855	\$ 259	\$ 242,147	\$ 86,213	\$ (102,050)	\$ 226,569

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,		
	2017	2018	2019
Cash flows from operating activities:			
Net income	\$ 37,193	\$ 11,645	\$ 14,533
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	15,979	17,430	17,771
Provision for losses on accounts receivable	2,198	1,841	1,618
Stock-based compensation expense	3,162	6,583	2,153
Deferred income tax expense (benefit)	(11,651)	3,823	10,117
Amortization of deferred financing costs	820	532	392
Amortization of capitalized commissions on preneed contracts	—	599	558
Accretion of discount on convertible subordinated notes	4,329	2,192	241
Accretion of discount on senior notes	—	272	492
Net loss on early extinguishment of debt	—	502	—
Net loss (gain) on sale of businesses and disposal of other assets	(710)	1,052	4,096
Goodwill and other impairments	—	1,019	963
Gain on insurance reimbursements	—	—	(879)
Other	—	—	121
Changes in operating assets and liabilities that provided (required) cash:			
Accounts and preneed receivables	(4,254)	(5,061)	(5,801)
Inventories, prepaid and other current assets	1,446	(159)	(2,762)
Intangible and other non-current assets	149	(390)	(251)
Preneed funeral and cemetery trust investments	2,373	488	(6,500)
Accounts payable	(3,649)	2,044	(580)
Accrued and other liabilities	(385)	3,990	1,271
Deferred preneed funeral and cemetery revenue	1,446	6,546	168
Deferred preneed funeral and cemetery receipts held in trust	(3,216)	(5,954)	5,495
Net cash provided by operating activities	<u>45,230</u>	<u>48,994</u>	<u>43,216</u>
Cash flows from investing activities:			
Acquisitions and land for new construction	(28,799)	(37,970)	(140,907)
Deposit on pending acquisition	—	—	(5,000)
Proceeds from insurance reimbursements	—	—	1,433
Net proceeds from sale of businesses and other assets	5,731	—	967
Capital expenditures	(16,395)	(13,526)	(15,379)
Net cash used in investing activities	<u>(39,463)</u>	<u>(51,496)</u>	<u>(158,886)</u>
Cash flows from financing activities:			
Payments against the term loan	(11,250)	(127,500)	—
Borrowings from the credit facility	106,900	124,500	174,961
Payments against the credit facility	(82,600)	(189,400)	(118,261)
Payment of debt issuance costs related to the credit facility	—	(1,751)	(891)
Redemption of the 2.75% convertible subordinated notes	—	(98,266)	(27)
Payment of transaction costs related to the redemption of the 2.75% convertible subordinated notes	—	(885)	—
Proceeds from the issuance of the 6.625% senior notes	—	320,125	76,688
Payment of debt issuance costs related to the 6.625% senior notes	—	(1,367)	(980)
Payments on long-term debt and obligations under finance leases	(1,962)	(1,940)	(2,287)
Payments on contingent consideration recorded at acquisition date	(101)	(138)	(162)
Proceeds from the exercise of stock options and employee stock purchase plan contributions	1,496	1,246	1,445
Taxes paid on restricted stock vestings and exercise of non-qualified options	(509)	(651)	(194)
Dividends paid on common stock	(3,709)	(5,513)	(5,398)
Purchase of treasury stock	(16,366)	(16,266)	(9,152)
Net cash provided by (used in) financing activities	<u>(8,101)</u>	<u>2,194</u>	<u>115,742</u>
Net increase (decrease) in cash and cash equivalents	(2,334)	(308)	72
Cash and cash equivalents at beginning of year	3,286	952	644
Cash and cash equivalents at end of year	<u>\$ 952</u>	<u>\$ 644</u>	<u>\$ 716</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, 2019, we operated 186 funeral homes in 29 states and 31 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.

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 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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. Balances due on undelivered preneed funeral trust contracts have been reclassified to reduce *Deferred preneed funeral revenue* on our Consolidated Balance Sheet of \$8.3 million and \$8.9 million at December 31, 2018 and December 31, 2019, respectively. As these performance obligations are to be completed after the date of death, we cannot quantify the recognition of revenue in future periods. However, we estimate an average maturity period of ten years for preneed funeral contracts.

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, 2019, CSV RIA provided investment management and advisory services to approximately 71% 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.

The earnings from our ancillary service businesses, which consist of a flower shop, a pet cremation business and an online cremation business are recorded as *Other revenue*, as noted in our table of disaggregated revenue in Note 6 to the Consolidated Financial Statements included herein.

The comparative information for years prior to 2018 has not been adjusted to reflect the adoption of the revised revenue recognition standard and is reported in accordance with Accounting Standards Codification 605 ("ASC 605"). See Note 2 "Recently Issued Accounting Standards" of our Annual Report on Form 10-K for the year ended December 31, 2018 for additional information related to our adoption of the revised revenue recognition standard ("ASC 606").

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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.

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.

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. Balances due from customers on delivered preneed cemetery contracts are included in *Accounts receivable* and *Preneed receivables* on our Consolidated Balance Sheet. Balances due on undelivered preneed cemetery contracts have been reclassified to reduce *Deferred preneed cemetery revenue* on our Consolidated Balance Sheet. The transaction price allocated to preneed merchandise and service performance obligations that were unfulfilled were \$4.4 million and \$4.8 million at December 31, 2018 and December 31, 2019, respectively. As these performance obligations are to be completed after the date of death, we cannot quantify the recognition of revenue in future periods. However, we estimate an average maturity period of eight years for preneed cemetery contracts.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Cemetery property was \$75.0 million and \$87.0 million, net of accumulated amortization of \$37.7 million and \$41.7 million at December 31, 2018 and December 31, 2019, respectively. 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 \$3.3 million, \$3.6 million and \$4.0 million for the years ended December 31, 2017, 2018 and 2019, respectively.

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

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 and \$9.9 million for December 31, 2018 and December 31, 2019, respectively. We estimate an allowance for doubtful accounts on these receivables based on our historical experience, which amounted to 2.2% of funeral receivables at both December 31, 2018 and December 31, 2019. In addition, our funeral receivables not related to funeral services performed were \$0.7 million and \$1.1 million at December 31, 2018 and December 31, 2019, respectively. Other receivables not related to our funeral home and cemetery operations were \$0.2 million and \$0.7 million at December 31, 2018 and December 31, 2019, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Our cemetery financed receivables totaled \$37.2 million and \$41.3 million at December 31, 2018 and December 31, 2019, respectively. The unearned finance charges associated with these receivables were \$4.6 million and \$4.5 million at December 31, 2018 and December 31, 2019, 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 are 90 days past due or more, which was approximately 4.6% and 4.4% of the total receivables at December 31, 2018 and December 31, 2019, 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 \$1.8 million and \$0.1 million related to perpetual care income receivables at December 31, 2018 and December 31, 2019, respectively. See Note 11 to the Consolidated Financial Statements included herein for additional information on our perpetual care trust investments.

Accounts receivable is comprised of the following at December 31, 2018 and December 31, 2019 (in thousands):

	<u>December 31, 2018</u>	<u>December 31, 2019</u>
Funeral receivables, net of allowance for bad debt of \$189 and \$223, respectively	\$ 9,002	\$ 10,758
Cemetery receivables, net of allowance for bad debt of \$580 and \$626, respectively	9,688	10,039
Other receivables	207	681
Accounts receivable, net	<u>\$ 18,897</u>	<u>\$ 21,478</u>

Preneed cemetery receivables represent payments expected to be received beyond one year from the balance sheet date. *Preneed cemetery receivables, net* are comprised of the following at December 31, 2018 and December 31, 2019 (in thousands):

	<u>December 31, 2018</u>	<u>December 31, 2019</u>
Preneed cemetery receivables	\$ 25,568	\$ 27,411
Less: unearned finance charges	(2,821)	(2,690)
Less: allowance for bad debt and contract cancellation	(1,228)	(1,290)
Less: balances due on undelivered cemetery preneed contracts	(3,078)	(3,258)
Preneed cemetery receivables, net	<u>\$ 18,441</u>	<u>\$ 20,173</u>

Bad debt expense totaled \$2.2 million, \$1.8 million and \$1.6 million for the years ended December 31, 2017, 2018 and 2019, respectively.

Capitalized Commissions on Preneed Contracts

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. Amortization expense totaled \$0.6 million for both the years ended December 31, 2018 and 2019. Prior to our adoption of ASC 606 on January 1, 2018, these costs were expensed in the period incurred.

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. There were no impairment losses recognized for the year ended December 31, 2019.

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.

See Note 13 to the Consolidated Financial Statements herein for additional information related to our capitalized commissions on preneed contracts.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Leases

We have operating and finance leases. We lease certain office facilities, certain funeral homes and equipment under operating leases with original terms ranging from one to nineteen years. Many leases include one or more options to renew, some of which include options to extend the leases for up to 26 years. We lease certain funeral homes under finance leases with original terms ranging from ten to forty years. We do not have lease agreements with residual value guarantees, sale-leaseback terms, material restrictive covenants or related parties. We do not have any material sublease arrangements.

We determine if an arrangement is a lease at inception based on the facts and circumstances of the agreement. A right-of-use (“ROU”) asset represents our right to use the underlying asset for the lease term and the lease liability represents our obligation to make lease payments arising from the lease. ROU assets and lease liabilities are recognized on our Consolidated Balance Sheet at the lease commencement date based on the present value of lease payments over the lease term. As our leases do not provide an implicit interest rate, we use our incremental borrowing rate based on the information available at the commencement date in determining the present value of lease payments. The lease terms used to calculate the ROU asset and related lease liability include options to extend the lease when it is reasonably certain that we will exercise that option. Lease expense for operating leases is recognized on a straight-line basis over the lease term as an operating expense, while the expense for finance leases (formerly capital leases) is recognized as depreciation expense and interest expense using the accelerated interest method of recognition. Variable lease payment amounts that cannot be determined at the commencement of the lease such as increases in lease payments based on changes in index rates or usage, are not included in the ROU assets or liabilities. These are expensed as incurred and recorded as variable lease expense. We have real estate lease agreements which require payments for lease and non-lease components and account for these as a single lease component. Leases with an initial term of 12 months or less, that do not include an option to renew the underlying asset, are not recorded on our Consolidated Balance Sheet and expense is recognized on a straight-line basis over the lease term. Operating lease ROU assets are included in Operating lease right-of-use assets and operating lease liabilities are included in Current portion of operating lease obligations and Obligations under operating leases, net of current portion on our Consolidated Balance Sheet. Finance lease ROU assets are included in Property, plant and equipment, net and finance lease liabilities are included in Current portion of finance lease obligations and Obligations under finance leases, net of current portion on our Consolidated Balance Sheet.

See Notes 2 and 17 to the Consolidated Financial Statements included herein for additional information related to our leases.

Property, Plant and Equipment

Property, plant and equipment (including equipment under finance 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 finance 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 is comprised of the following at December 31, 2018 and 2019 (in thousands):

	December 31, 2018	December 31, 2019
Land	\$ 81,012	\$ 84,608
Buildings and improvements	223,646	242,641
Furniture, equipment and automobiles	81,125	88,046
Property, plant and equipment, at cost	385,783	415,295
Less: accumulated depreciation	(124,945)	(136,095)
Property, plant and equipment, net	\$ 260,838	\$ 279,200

During 2019, we acquired \$21.7 million of property, plant and equipment in connection with the funeral home and cemetery businesses we acquired during 2019, as further discussed in Note 3 to the Consolidated Financial Statements included herein. During 2018, we acquired \$17.5 million of property, plant and equipment in connection with the funeral home businesses we acquired during 2018. We recorded depreciation expense of \$12.6 million, \$13.8 million and \$13.8 million for the years ended December 31, 2017, 2018 and 2019, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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.

For the year ended December 31, 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, 2017 and 2019, no impairment was 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 2019, we acquired, in three separate transactions, two funeral home and cemetery combination businesses, seven funeral home businesses and three ancillary businesses. In October 2019, we acquired the following: (i) four funeral home business in Buffalo, New York; and (ii) one funeral home and cemetery combination business, three funeral home businesses and three ancillary businesses, which consist of a flower shop, a pet cremation business and an online cremation business in the Dallas, Texas area. In December 2019, we acquired one funeral home and cemetery combination business in Fairfax, Virginia.

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.

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 related to our acquisitions.

Goodwill

The excess of the purchase price over the fair value of identifiable net assets of funeral home businesses and cemeteries acquired is recorded as goodwill. 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.

We perform our annual goodwill impairment test as of August 31st each year. 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 conducted qualitative assessments in 2017 and 2018; however, we performed a quantitative assessment in 2019. In addition to our annual test, 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.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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 2019 quantitative assessment, there was no impairment to goodwill as the fair value of our reporting units was greater than the carrying value. However, we recorded a goodwill impairment of \$0.5 million during 2019 related to a funeral home business that we divested in the fourth quarter of 2019. We also recorded a \$0.2 million goodwill impairment during the year ended December 31, 2019 related to a funeral home business that is under a letter of intent to sell during 2020, as the carrying value exceeded fair value at December 31, 2019.

For our 2018 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. However, we recorded a goodwill impairment of \$0.8 million during 2018 related to a funeral home business that we divested during the third quarter of 2019. No impairments were recorded to our goodwill during the year ended December 31, 2017.

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, net* 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.

We perform our annual intangible assets impairment test as of August 31st each year. 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 conducted qualitative assessments in 2017 and 2018; however, we performed a quantitative assessment in 2019. In addition to our annual test, 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.

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, then an impairment charge is recorded in an amount equal to the difference.

For our 2019 quantitative assessment, we recorded an impairment for tradenames of \$0.2 million during the year ended December 31, 2019 as the carrying amount of certain tradenames exceeded the fair value. No impairments were recorded to our intangible assets during the years ended December 31, 2017 and 2018.

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

Divested Operations

During 2019, we divested three funeral home businesses whose building leases expired and sold a funeral home business for \$0.9 million. In addition, we merged a funeral home business with a business in an existing market. During 2018, our management agreement with a Florida municipality expired and as a result, we divested three of our cemetery businesses. During 2017, we sold a funeral home business in Kentucky for \$0.6 million. The operating results of these divested businesses are reflected in our Consolidated Statements of Operations.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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, 2019, 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 years ended December 31, 2018 and 2019.

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 related to our 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 15 states in which we operate and combined or unitary income tax returns in 14 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.

The Company's unrecognized tax benefits reserve for uncertain tax positions primarily relates to pending accounting method changes filed for the tax year ended December 31, 2018. The amount of the reserve recorded as of December 31, 2019 was \$3.2 million. No reserve is recorded at December 31, 2018.

See Note 19 to the Consolidated Financial Statements included herein for additional information related to our income taxes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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 benefit or expense 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, 2018 and 2019, the excess tax deficiency related to share-based payments was approximately \$0.8 million and \$0.4 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 on the Consolidated Statements of Cash Flows.

See Note 20 to the Consolidated Financial Statements included herein for additional information related to 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 15).

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, 2017, 2018 and 2019, and the corresponding calculation of fully diluted earnings per share, included 941,000, 337,000 and 10,000 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 22 to the Consolidated Financial Statements included herein for the computation of per share earnings for the years ended December 31, 2017, 2018 and 2019.

Subsequent Events

We have evaluated events and transactions during the period subsequent to December 31, 2019 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

Leases

In February 2016, the Financial Accounting Standards Board (“FASB”) issued an Accounting Standards Update (“ASU”) related to *Leases (Topic 842)* and subsequent amendments, collectively referred to as (“Topic 842”) to increase transparency and comparability among organizations by requiring the recognition of ROU assets and lease liabilities on the balance sheet for all leases, including operating leases. The ROU asset represents the right to use the underlying asset for the lease term and the lease liability represents the obligation to make lease payments arising from the lease. Finance leases were not impacted by Topic 842, as finance lease liabilities and the corresponding ROU assets were already recorded on the balance sheet under the previous guidance Topic 840, *Leases*.

On January 1, 2019, we adopted Topic 842 using the modified retrospective method for all lease arrangements at the beginning of the period of adoption. Results for reporting periods beginning January 1, 2019, are presented under Topic 842, while prior period amounts have not been adjusted and continue to be reported in accordance with Topic 840. While Topic 842 had a material

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

impact on our Consolidated Balance Sheet, it did not have a material impact on our Consolidated Statements of Operations or Cash Flows, or liquidity measures, such as debt covenant ratios. It also did not have a material impact on our effective tax rate for the reporting period. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases. For leases that commenced before the effective date of Topic 842, we elected the permitted practical expedients to not reassess the following: (i) whether any expired or existing contracts contain leases; (ii) the lease classification for any expired or existing leases; and (iii) initial direct costs for any existing leases. We also elected to exclude leases with a term of 12 months or less in the recognized ROU assets and lease liabilities. We have real estate lease agreements which require payments for lease and non-lease components and have elected to account for these as a single lease component. We have elected the short-term lease recognition exemption for all applicable classes of underlying assets.

On January 1, 2019, we recorded operating lease ROU assets of \$16.5 million and operating lease liabilities of \$17.3 million, related to our real estate and equipment leases, based on the present value of the future lease payments on the date of adoption. Our opening operating lease ROU asset balance included prepaid lease expense and lease incentives on our Consolidated Balance Sheet at December 31, 2018. The cumulative effect of changes made to our opening Consolidated Balance Sheet on January 1, 2019, for the adoption of Topic 842 is as follows (in thousands):

	<u>December 31, 2018</u>	<u>Effect of Adoption of Topic 842</u>	<u>January 1, 2019</u>
Assets			
Prepaid expenses	\$ 1,456	\$ (148)	\$ 1,308
Operating lease right-of-use assets	—	16,470	16,470
		<u>\$ 16,322</u>	
Liabilities			
Accrued and other liabilities	\$ 22,644	\$ (274)	\$ 22,370
Other long-term liabilities	3,133	(692)	2,441
Current portion of operating lease obligations	—	\$ 2,633	2,633
Obligations under operating leases, net of current portion	—	14,655	14,655
		<u>\$ 16,322</u>	

See Note 17 to the Consolidated Financial Statements included herein for the additional disclosures required by Topic 842.

We have no material leases in which we are the lessor.

Accounting Pronouncements Not Yet Adopted

Financial Instruments - Credit Losses

In June 2016, the FASB issued ASU, *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments* and subsequent amendments collectively known as (Topic 326). This ASU applies to all entities holding financial assets measured at amortized cost, including loans, trade and financed receivables and other financial instruments. The guidance introduces a new credit reserving model known as Current Expected Credit Loss (“CECL”), which requires earlier recognition of credit losses, while also providing additional transparency about credit risk. The CECL model utilizes a lifetime expected credit loss measurement objective for the recognition of credit losses at the time the financial asset is originated or acquired. The CECL model requires all expected credit losses to be measured based on historical experience, current conditions and reasonable and supportable forecasts about collectability.

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 using the modified retrospective approach.

We believe that our current process of analyzing and calculating our allowance for doubtful accounts on trade receivables and the allowance for contract cancellations on financed receivables considers the credit risk of our customers and accounts for the recognition of credit losses at inception. Our customer base is generally a homogeneous pool of consumers based in the United States that, as a group, have a similar level of credit risk that are less subject to material economic and demographic changes. Additionally, our trade receivables are short term in nature (outstanding less than 90 days). Therefore, due to the similar level of credit risk of our customer base and the short-term nature of our receivables, we use our historical loss experience to forecast future collectability of our trade receivables and record an allowance at each reporting period. Our current contract cancellation policy on cemetery financed receivables requires that we record an allowance at the date that the sale is recognized as revenue. Additionally, we reserve 100% of the receivable on contracts in which the revenue has been recognized and payments are 90 days past due or more. Because we believe our current processes already consider credit risk and recognize credit losses at inception, we do not expect the adoption of this ASU to have a material impact on our consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In addition, the new guidance prospectively replaces the other-than-temporary impairment model for available-for-sale debt securities and requires the recognition of an allowance for reductions in a security's fair value attributable to declines in credit quality, instead of a direct write-down of the security, when a valuation decline is determined to be other-than-temporary. We are currently establishing a policy where we review our available-for-sale securities at each reporting period and perform an analysis on securities whose fair value is less than amortized cost to determine if impairment is appropriate. If the analysis of the security reflects impairment, we will perform a present value calculation of the future cash flows on the respective security using the effective interest rate implicit in the security at the date of acquisition. The impairment recognized will be the greater of the current fair market value or the present value of the future cash flows of the security. We do not expect the impact of the new guidance on available-for-sale securities to be material to our consolidated financial statements upon adoption.

Income Taxes

In December 2019, the FASB issued ASU, *Income Taxes* (Topic 740), to simplify the accounting for income taxes. The amendments in this update are effective for fiscal years beginning after December 15, 2020, with early adoption permitted. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2021 and are currently evaluating the impact of adoption on our consolidated financial statements.

3. ACQUISITIONS

On October 9, 2019, we acquired four funeral home businesses in Buffalo, New York for \$15.3 million in cash. On October 28, 2019, we acquired one funeral home and cemetery combination business, three funeral home businesses and three ancillary service businesses, which consist of a flower shop, a pet cremation business and an online cremation business, in the Dallas, Texas area for \$23.6 million in cash. We acquired substantially all the assets and assumed certain operating liabilities of these businesses.

On December 31, 2019, pursuant to the Transactions Agreement dated November 25, 2019 with Calvary Memorial Park, Inc. and Fairfax Memorial Funeral Home, LLC ("the Agreement"), all of the outstanding equity interests of the Fairfax, Virginia funeral and cemetery combination businesses were acquired for \$102.0 million in cash. The funeral home business was operated by a limited liability company that was treated as a partnership for federal tax purposes prior to the acquisition date, and therefore, the acquisition of all of the outstanding membership units of the partnership were treated as an asset acquisition. The cemetery business was operated by an S corporation prior to the acquisition date, and therefore, consent was obtained from the selling S corporation shareholders to make a 338(h)(10) election under the Internal Revenue Code ("the Election"), which allowed us to treat the acquisition of the stock of the cemetery business as an asset acquisition and allowed us to record the assets and liabilities at fair value. Pursuant to the Agreement, a portion of the purchase price is being held in escrow to reimburse the sellers for certain incremental taxes resulting from the Election. These funds must be distributed by December 31, 2020, and if they are not fully utilized, the remaining portion of such funds will be returned to us and the purchase price and goodwill will be reduced by that amount. A portion of the purchase price is also being held in escrow as an indemnity obligation holdback to cover potential indemnification obligations of the sellers, which will be released pursuant to the terms of the Agreement.

The pro forma impact of these acquisitions on prior periods is not presented, as the impact is not significant to our reported results. The results of the acquired businesses are reflected in our Consolidated Statements of Operations from the date of acquisition. As of December 31, 2019, our accounting for our 2019 acquisitions was not complete.

The following table summarizes the breakdown of the purchase price allocation for the businesses described above (in thousands):

	Purchase Price Allocation
Current assets	\$ 1,482
Preneed trust assets	15,891
Property, plant & equipment	21,680
Cemetery property	11,994
Goodwill	99,344
Intangible and other non-current assets	8,269
Assumed liabilities	(657)
Preneed trust liabilities	(15,463)
Deferred revenue	(1,633)
Purchase price	<u>\$ 140,907</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The intangible and other non-current assets relate to the fair value of tradenames and agreements not-to-compete. The assumed liabilities primarily relate to the obligations associated with accounts payable and payroll related liabilities of the Fairfax, Virginia acquisition.

The following table summarizes the fair value of the assets acquired for these businesses (in thousands):

Acquisition Date	Type of Business	Market	Assets Acquired (Excluding Goodwill)	Goodwill Recorded	Liabilities and Debt Assumed
October 9, 2019	Four Funeral Homes	Buffalo, NY	\$ 8,147	\$ 7,135	\$ —
October 28, 2019	One Funeral Home and Cemetery Combination, Three Funeral Homes and Three Ancillary Businesses	Dallas, TX	\$ 16,148	\$ 13,956	\$ (6,479)
December 31, 2019	One Funeral Home and Cemetery Combination	Fairfax, VA	\$ 35,021	\$ 78,253	\$ (11,274)

During 2018, we acquired two funeral home businesses in Fredericksburg, Virginia and one in Stafford, Virginia for \$29.2 million in cash. We acquired a funeral home business in Cookeville, Tennessee for \$2.8 million in cash. We also acquired one funeral home business on Knightdale, North Carolina for \$6.0 million in cash.

The following table summarizes the breakdown of the purchase price allocation for the businesses acquired during 2018 (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 the businesses acquired during 2018 (in thousands):

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	\$ 13,210	\$ 15,990	\$ —
August 21, 2018	One Funeral Home	Cookeville, TN	\$ 2,412	\$ 527	\$ (189)
August 28, 2018	One Funeral Home	Knightdale, NC	\$ 5,950	\$ 260	\$ (210)

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, which 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 and cemeteries acquired is recorded as goodwill.

Our 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. 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. For our 2019 annual impairment test, we performed a quantitative assessment and determined that there was no impairment to goodwill as the fair value of our reporting units was greater than the carrying value.

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, 2018 and 2019 (in thousands):

	<u>December 31, 2018</u>	<u>December 31, 2019</u>
Goodwill at the beginning of year	\$ 287,956	\$ 303,887
Increase in goodwill related to acquisitions	16,777	99,344
Decrease in goodwill related to divestitures	—	(4,197)
Decrease in goodwill related to impairments	(846)	(742)
Goodwill at the end of the year	<u>\$ 303,887</u>	<u>\$ 398,292</u>

During year ended December 31, 2019, we recognized \$99.3 million in goodwill related to our acquisitions; \$36.9 million was allocated to our cemetery segment and \$62.4 million was allocated to our funeral home segment.

During year ended December 31, 2019, we sold a funeral home business with a \$4.2 million carrying value of goodwill for a loss recorded in *Other, net*. See Note 5 to the Consolidated Financial Statements included herein, for a discussion of our divested businesses.

During year ended December 31, 2019, we also recorded a goodwill impairment of \$0.5 million in *Other, net*, related to a funeral home business that we divested in the fourth quarter of 2019 and a \$0.2 million goodwill impairment related to a funeral home business that is under a letter of intent to sell during 2020, as the carrying value exceeded fair value at December 31, 2019.

During the year ended December 31, 2018, we recorded an impairment of \$0.8 million related to a funeral home business that we divested during the third quarter of 2019.

5. DIVESTED OPERATIONS

During 2019, we divested three funeral home businesses whose building leases expired and sold a funeral home business for \$0.9 million. In addition, we merged a funeral home business with a business in an existing market. During 2018, our management agreement with a Florida municipality expired and as a result, we divested three of our cemetery businesses. During 2017, we sold a funeral home business in Kentucky for \$0.6 million.

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>2017</u>	<u>2018</u>	<u>2019</u>
Revenue	\$ 605	\$ 4,712	\$ 805
Operating income (loss)	277	1,130	(569)
Other, net ⁽¹⁾	191	(349)	(3,883)
Income tax benefit (provision)	(187)	(246)	1,288
Net income (loss) from divested operations	<u>\$ 281</u>	<u>\$ 535</u>	<u>\$ (3,164)</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, 2019

	Funeral	Cemetery	Total
Services	\$ 131,636	\$ 10,918	\$ 142,554
Merchandise	75,682	7,665	83,347
Cemetery property	—	31,167	31,167
Other revenue	9,550	7,489	17,039
Total	\$ 216,868	\$ 57,239	\$ 274,107

For The Year Ended, December 31, 2018

	Funeral	Cemetery	Total
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	\$ 210,725	\$ 57,267	\$ 267,992

For The Year Ended, December 31, 2017 ^(a)

	Funeral	Cemetery	Total
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	\$ 200,886	\$ 57,253	\$ 258,139

(a) The comparative information for year ended December 31, 2017 has not been adjusted to reflect the adoption of the revised revenue recognition standard and is reported in accordance with Accounting Standards Codification 605 (“ASC 605”).

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, 2018 and 2019 are as follows (in thousands):

	December 31, 2018	December 31, 2019
Preneed cemetery trust investments, at market value	\$ 64,549	\$ 74,572
Less: allowance for contract cancellation	(2,117)	(2,190)
Preneed cemetery trust investments, net	\$ 62,432	\$ 72,382

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

of the trust, in which case a loss provision is recorded. At December 31, 2019, 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 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 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, 2019. 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, 2019 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$ 5,729	\$ —	\$ —	\$ 5,729
Fixed income securities:					
Foreign debt	2	5,609	312	(243)	5,678
Corporate debt	2	16,916	1,044	(649)	17,311
Preferred stock	2	14,206	904	(164)	14,946
Mortgage-backed securities	2	517	—	(114)	403
Common stock	1	28,569	2,766	(3,017)	28,318
Mutual funds:					
Fixed Income	2	1,463	72	(85)	1,450
Trust securities		<u>\$ 73,009</u>	<u>\$ 5,098</u>	<u>\$ (4,272)</u>	<u>\$ 73,835</u>
Accrued investment income		<u>\$ 737</u>			<u>\$ 737</u>
Preneed cemetery trust investments					<u>\$ 74,572</u>
Market value as a percentage of cost					<u>101.1%</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	4,518
Due in five to ten years	10,395
Thereafter	23,425
Total fixed income securities	<u>\$ 38,338</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The cost and 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>

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, 2018 and 2019. 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, 2019, 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, 2019 are shown in the following tables (in thousands):

	December 31, 2019					
	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	\$ 268	\$ (42)	\$ 758	\$ (201)	\$ 1,026	\$ (243)
Corporate debt	1,368	(168)	4,520	(481)	5,888	(649)
Preferred stock	4,135	(164)	—	—	4,135	(164)
Mortgage-backed securities	—	—	402	(114)	402	(114)
Common stock	5,079	(652)	4,178	(2,365)	9,257	(3,017)
Mutual funds:						
Fixed Income	532	(85)	—	—	532	(85)
Total temporary impaired securities	<u>\$ 11,382</u>	<u>\$ (1,111)</u>	<u>\$ 9,858</u>	<u>\$ (3,161)</u>	<u>\$ 21,240</u>	<u>\$ (4,272)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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>

Preneed cemetery trust investment security transactions recorded in *Other, net* on our Consolidated Statements of Operations for the years ended December 31, 2017, 2018 and 2019 are as follows (in thousands):

	Years ended December 31,		
	2017	2018	2019
Investment income	\$ 2,250	\$ 1,596	\$ 1,743
Realized gains	2,218	4,546	6,353
Realized losses	(2,384)	(5,817)	(4,677)
Expenses and taxes	(1,308)	(907)	(1,313)
Net change in deferred preneed cemetery receipts held in trust	(776)	582	(2,106)
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Purchases and sales of investments in the preneed cemetery trusts for the years ended December 31, 2017, 2018 and 2019 are as follows (in thousands):

	Years ended December 31,		
	2017	2018	2019
Purchases	\$ (21,966)	\$ (27,006)	\$ (40,984)
Sales	14,002	39,180	29,635

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, 2018 and 2019 are as follows (in thousands):

	December 31, 2018	December 31, 2019
Preneed funeral trust investments, at market value	\$ 84,803	\$ 99,246
Less: allowance for contract cancellation	(2,729)	(2,911)
Preneed funeral trust investments	<u>\$ 82,074</u>	<u>\$ 96,335</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, 2019, none of our preneed funeral trust investments were underfunded.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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, common stock and equity mutual funds. 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 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, 2019. 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.

The cost and fair market values associated with preneed funeral trust investments at December 31, 2019 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$ 24,160	\$ —	\$ —	\$ 24,160
Fixed income securities:					
U. S. treasury debt	1	822	—	—	822
Foreign debt	2	5,587	309	(232)	5,664
Corporate debt	2	16,109	992	(646)	16,455
Preferred stock	2	14,094	874	(198)	14,770
Mortgage-backed securities	2	585	—	(117)	468
Common stock	1	27,652	2,773	(2,869)	27,556
Mutual funds:					
Equity	1	772	617	(4)	1,385
Fixed income	2	4,364	107	(107)	4,364
Other investments	2	2,902	—	—	2,902
Trust securities		<u>\$ 97,047</u>	<u>\$ 5,672</u>	<u>\$ (4,173)</u>	<u>\$ 98,546</u>
Accrued investment income		<u>\$ 700</u>			<u>\$ 700</u>
Preneed funeral trust investments					<u>\$ 99,246</u>
Market value as a percentage of cost					<u>101.5%</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	5,456
Due in five to ten years	9,656
Thereafter	23,067
Total fixed income securities	<u>\$ 38,179</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The cost and 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>

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, 2018 and 2019. 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, 2019, 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, 2019 are shown the the following tables (in thousands):

	December 31, 2019					
	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	\$ 274	\$ (43)	\$ 723	\$ (189)	\$ 997	\$ (232)
Corporate debt	1,403	(172)	4,433	(474)	5,836	(646)
Preferred stock	4,412	(198)	—	—	4,412	(198)
Mortgage-backed securities	—	—	439	(117)	439	(117)
Common Stock	4,732	(625)	4,068	(2,244)	8,800	(2,869)
Mutual funds:						
Equity and Other	—	—	48	(4)	48	(4)
Fixed income	668	(56)	1,021	(51)	1,689	(107)
Total temporary impaired securities	<u>\$ 11,489</u>	<u>\$ (1,094)</u>	<u>\$ 10,732</u>	<u>\$ (3,079)</u>	<u>\$ 22,221</u>	<u>\$ (4,173)</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, 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:						
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>

Preneed funeral trust investment security transactions recorded in *Other, net* on our Consolidated Statements of Operations for the years ended December 31, 2017, 2018 and 2019 are as follows (in thousands):

	Years ended December 31,		
	2017	2018	2019
Investment income	\$ 2,420	\$ 1,623	\$ 1,753
Realized gains	2,386	6,662	6,214
Realized losses	(2,396)	(5,882)	(4,612)
Expenses and taxes	(1,290)	(885)	(1,129)
Net change in deferred preneed funeral receipts held in trust	(1,120)	(1,518)	(2,226)
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Purchases and sales of investments in the preneed funeral trusts for the years ended December 31, 2017, 2018 and 2019 are as follows (in thousands):

	Years ended December 31,		
	2017	2018	2019
Purchases	\$ (21,954)	\$ (28,264)	\$ (38,984)
Sales	14,463	39,955	29,983

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 are comprised of the following at December 31, 2018 and December 31, 2019 (in thousands):

	December 31, 2018	December 31, 2019
Cemetery interment rights	\$ 27,728	\$ 31,366
Cemetery merchandise and services	9,516	9,950
Cemetery financed receivables	<u>\$ 37,244</u>	<u>\$ 41,316</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Our cemetery financed receivables presented on our Consolidated Balance Sheet at December 31, 2018 and December 31, 2019 are as follows (in thousands):

	December 31, 2018	December 31, 2019
Accounts receivable, including unearned finance charges and allowance for contract cancellations of \$2,405 and \$2,458, respectively	\$ 11,676	\$ 13,905
Preneed receivables, including unearned finance charges and allowance for contract cancellations of \$4,049 and \$3,980, respectively	25,568	27,411
Cemetery financed receivables	\$ 37,244	\$ 41,316

The unearned finance charges associated with these receivables were \$4.6 million and \$4.5 million at December 31, 2018 and 2019, 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 4.4% of the total receivables on recognized sales at December 31, 2019. 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, 2018 and 2019, the change in the allowance for contract cancellations is as follows (in thousands):

	As of December 31,	
	2018	2019
Beginning balance	\$ 2,019	\$ 1,808
Write-offs and cancellations	(1,357)	(733)
Provision	1,146	841
Ending balance	\$ 1,808	\$ 1,916

The aging of past due financing receivables as of December 31, 2019 is 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	\$ 745	\$ 392	\$ 148	\$ 1,209	\$ 2,494	\$ 28,382	\$ 30,876
Deferred revenue	219	121	147	302	789	9,651	10,440
Total contracts	\$ 964	\$ 513	\$ 295	\$ 1,511	\$ 3,283	\$ 38,033	\$ 41,316

The aging of past due financing receivables as of December 31, 2018 is 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	\$ 916	\$ 560	\$ 196	\$ 1,428	\$ 3,100	\$ 34,144	\$ 37,244

9. RECEIVABLES FROM PRENEED TRUSTS

Our *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, 2018 and 2019, receivables from preneed trusts are as follows (in thousands):

	December 31, 2018	December 31, 2019
Preneed trust funds, at cost	\$ 17,601	\$ 18,581
Less: allowance for contract cancellation	(528)	(557)
Receivables from preneed trusts, net	\$ 17,073	\$ 18,024

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, 2018 and 2019. The cost basis includes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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, 2019 is as follows (in thousands):

	Historical Cost Basis	Fair Value
As of December 31, 2019		
Cash and cash equivalents	\$ 4,533	\$ 4,533
Fixed income investments	11,603	11,603
Mutual funds and common stocks	2,440	2,518
Annuities	5	5
Total	\$ 18,581	\$ 18,659

The composition of the preneed trust funds at December 31, 2018 is 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	\$ 17,601	\$ 17,555

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 \$388.2 million and \$408.8 million at December 31, 2018 and 2019, 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.

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, 2018 and 2019 are as follows (in thousands):

	December 31, 2018	December 31, 2019
Cemetery perpetual care trust investments, at market value	\$ 44,071	\$ 64,047
Obligations due from trust	(577)	(631)
Care trusts' corpus	\$ 43,494	\$ 63,416

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, 2019, 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, common stock and equity mutual funds. Where quoted market prices are not available for the specific security, then fair values are estimated by using quoted prices of

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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 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, 2019. 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, 2019 (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$ 4,624	\$ —	\$ —	\$ 4,624
Fixed income securities:					
Foreign debt	2	4,200	238	(175)	4,263
Corporate debt	2	11,658	802	(534)	11,926
Preferred stock	2	10,782	666	(106)	11,342
Mortgage-backed securities	2	324	—	(71)	253
Common stock	1	21,594	3,399	(1,911)	23,082
Mutual funds:					
Equity	1	233	146	(1)	378
Fixed income	2	7,156	618	(107)	7,667
Trust securities		<u>\$ 60,571</u>	<u>\$ 5,869</u>	<u>\$ (2,905)</u>	<u>\$ 63,535</u>
Accrued investment income		<u>\$ 512</u>			<u>\$ 512</u>
Cemetery perpetual care investments					<u>\$ 64,047</u>
Market value as a percentage of cost					<u>104.9%</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	3,130
Due in five to ten years	6,786
Thereafter	17,868
Total fixed income securities	<u>\$ 27,784</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, 2018 (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
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>

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 years ended December 31, 2018 and 2019.

At December 31, 2019, 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, 2019 are shown in the following tables (in thousands):

	December 31, 2019					
	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	\$ 168	\$ (26)	\$ 549	\$ (149)	\$ 717	\$ (175)
Corporate debt	1,057	(196)	3,253	(338)	4,310	(534)
Preferred stock	2,989	(106)	—	—	2,989	(106)
Mortgage-backed securities	—	—	252	(71)	252	(71)
Common stock	3,299	(463)	2,657	(1,448)	5,956	(1,911)
Mutual funds:						
Equity and Other	2	—	18	(1)	20	(1)
Fixed income	732	(94)	360	(13)	1,092	(107)
Total temporary impaired securities	<u>\$ 8,247</u>	<u>\$ (885)</u>	<u>\$ 7,089</u>	<u>\$ (2,020)</u>	<u>\$ 15,336</u>	<u>\$ (2,905)</u>

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, 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	<u>\$ 21,221</u>	<u>\$ (3,612)</u>	<u>\$ 4,492</u>	<u>\$ (1,727)</u>	<u>\$ 25,713</u>	<u>\$ (5,339)</u>

Perpetual care trust investment security transactions recorded in *Other, net* on our Consolidated Statements of Operations for the years ended December 31, 2017, 2018 and 2019 are as follows (in thousands):

	Years ended December 31,		
	2017	2018	2019
Realized gains	\$ 926	\$ 1,364	\$ 1,663
Realized losses	(1,195)	(1,896)	(1,258)
Net change in Care trusts' corpus	269	532	(405)
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Perpetual care trust investment security transactions recorded in *Other revenue* for the years ended December 31, 2017, 2018 and 2019 are as follows (in thousands):

	Years ended December 31,		
	2017	2018	2019
Investment income	\$ 5,949	\$ 5,934	\$ 4,500
Realized losses, net	(838)	(1,355)	(377)
Total	<u>\$ 5,111</u>	<u>\$ 4,579</u>	<u>\$ 4,123</u>

Purchases and sales of investments in the perpetual care trusts for the years ended December 31, 2017, 2018 and 2019 are as follows (in thousands):

	Years ended December 31,		
	2017	2018	2019
Purchases	\$ (13,923)	\$ (17,313)	\$ (26,573)
Sales	8,899	25,786	17,588

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 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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

fair value of the Convertible Notes (as defined in Note 15) was approximately \$7.8 million at December 31, 2019 based on the last traded or broker quoted price. The fair value of the Senior Notes (as defined in Note 16) was approximately \$426.4 million at December 31, 2019 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, 2018 and 2019, 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, 2018 and 2019 are as follows (in thousands):

	December 31, 2018	December 31, 2019
Prepaid agreements not-to-compete, net of accumulated amortization of \$6,672 and \$7,195, respectively	\$ 4,048	\$ 3,915
Tradenames	17,635	25,233
Capitalized commissions on preneed contracts, net of accumulated amortization of \$599 and \$1,127, respectively	2,717	2,818
Other	25	150
Intangible and other non-current assets	\$ 24,425	\$ 32,116

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 \$0.6 million, \$0.6 million and \$0.7 million for the years ended December 31, 2017, 2018 and 2019, respectively. During the years ended December 31, 2018 and 2019, we increased prepaid agreements not-to-compete by \$0.8 million and \$0.4 million related to our 2018 and 2019 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, 2018 and 2019, we increased tradenames by \$3.3 million and \$7.8 million related to our 2018 and 2019 acquisitions described in Note 3 to the Consolidated Financial Statements included herein. During 2019, we recorded an impairment to tradenames of \$0.2 million as a result of our 2019 annual impairment test as the carrying amount of certain tradenames exceeded the fair value. We did not record an impairment to tradenames in the year ended December 31, 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.

We capitalize our selling costs related to preneed cemetery merchandise and services and preneed funeral trust contracts. These costs 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. Prior to our adoption of ASC 606 on January 1, 2018, these costs were expensed in the period incurred. Amortization expense totaled \$0.6 million for both the years ended December 31, 2018 and 2019.

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. There were no impairment losses recognized for the year ended

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 31, 2019. 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 May 31, 2018, we completed the issuance of \$325.0 million in aggregate principal amount of our 6.625% senior notes due (the “Initial Senior Notes”). See Note 16 to the Consolidated Financial Statements included herein for further discussion of the sale of the Initial Senior Notes.

We used \$291.4 million of the net proceeds from the sale of the Initial Senior Notes to repay all amounts outstanding under our former credit agreement. 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 senior secured revolving credit facility (as defined below).

On May 31, 2018, we entered into a \$150.0 million senior secured revolving credit facility with the financial institutions party thereto, as lenders, and Bank of America, N.A., as administrative agent, which we subsequently amend in November 2018 and July 2019.

For the year ended December 31, 2018, we recognized a loss of \$1.6 million, recorded in *Net loss on early extinguishment of debt*, related to the termination of our former credit agreement, which consisted of a write-off of \$0.7 million of transaction costs and a write-off of \$0.9 million of unamortized debt issuance costs. Additionally, we incurred \$1.1 million in transaction costs related to our senior secured revolving credit facility, which were capitalized and will be amortized over the remaining term of the related debt using the straight-line method.

On December 19, 2019, we entered into a third amendment and commitment increase (“Credit Facility”) to our \$150.0 million senior secured revolving credit facility with the financial institutions party thereto, as lenders, and Bank of America, N.A., as administrative agent (in such capacity, the “Administrative Agent”) to increase our commitment to \$190.0 million. The Credit Facility is comprised of:

(i) a \$190.0 million revolving credit facility, which includes a \$15.0 million subfacility for letters of credit and a \$10.0 million swingline, and

(ii) an accordion or incremental option allowing for future increases in the facility size by an additional amount of up to \$75.0 million in the form of increased revolving commitments or incremental term loans.

The final maturity of the Credit Facility will occur on May 31, 2023.

For the year ended December 31, 2019, we incurred \$0.9 million in transactions costs related to our Credit Facility, which were capitalized and will be amortized over the remaining term of the related debt using the straight-line method.

The Company’s obligations under the Credit Facility are unconditionally guaranteed on a joint and several basis by the same subsidiaries which guarantee the Senior Notes (as defined in Note 16) and certain of the Company’s Credit Facility Guarantors.

The Credit Facility is secured by a first-priority perfected security interest in and lien on substantially all of the Company’s personal property assets and those of the Credit Facility Guarantors. In the event the Company’s actual Total Leverage Ratio is not at least 0.25 less than the required Total Leverage Ratio covenant level, at the discretion of the Administrative Agent, the Administrative Agent may unilaterally compel the Company and the Credit Facility Guarantors to grant and perfect first-priority mortgage liens on fee-owned real property assets which account for no less than 50% of funeral operations EBITDA.

The 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 the Company’s business and the maintenance of existing rights and privileges, the maintenance of property and insurance, amongst others.

In addition, the Credit Facility also contains customary negative covenants, including, but not limited to, covenants that restrict (subject to certain exceptions) the ability of the Company and the Credit Facility Guarantors to incur indebtedness, grant liens, make investments, engage in acquisitions, mergers or consolidations, and pay dividends and other restricted payments, and the following financial maintenance covenants: (A) a Total Leverage Ratio not to exceed (i) 6.00 to 1.00 for the quarter ended December 31, 2019, (ii) 5.75 to 1.00 for the quarters ended March 31, 2020, June 30, 2020 and September 30, 2020 and (iii) 5.50 to 1.00 for the quarter ended December 31, 2020 and each quarter ended thereafter, (B) a Senior Secured Leverage Ratio (as defined in the Credit Facility) not to exceed 2.00 to 1.00 as of the end of any period of four consecutive fiscal quarters, and (C) a Fixed Charge Coverage Ratio (as defined in the Credit Facility) of not less than 1.20 to 1.00 as of the end of any period of four consecutive fiscal quarters. Effective with the Credit Facility, an applicable rate premium shall be set forth in reference to the Total Leverage Ratio and increases by 0.500% whenever the most recent compliance certificate delivered indicates that the Total Leverage Ratio is greater than 5.00 to 1.00. The financial maintenance covenants will be calculated for the Company and its subsidiaries on a consolidated basis.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Our long-term debt consisted of the following at December 31, 2018 and 2019 (in thousands):

	December 31, 2018	December 31, 2019
Credit Facility	\$ 27,100	\$ 83,800
Acquisition debt	8,940	6,964
Debt issuance costs, net of accumulated amortization of \$108 and \$337	(955)	(1,618)
Less: current portion	(2,015)	(1,306)
Total long-term debt	\$ 33,070	\$ 87,840

As of December 31, 2019, we had outstanding borrowings under the Credit Facility of \$83.8 million. We had one letter of credit issued on November 30, 2018 and outstanding under the Credit Facility for approximately \$2.0 million, which bears interest at 2.125% and will expire on November 25, 2020. The letter of credit automatically renews annually and secures our obligations under our various self-insured policies. Outstanding borrowings under our 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, 2019, the prime rate margin was equivalent to 1.5% and the LIBOR rate margin was 2.5%. The weighted average interest rate on our Credit Facility for the years ended December 31, 2018 and 2019 was 4.0% and 2.9%, respectively.

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 Credit Facility. Additionally, we do not currently have any significant restrictions on our ability to receive dividends or loans from any Credit Facility Guarantors.

We are in compliance with the covenants contained in our Credit Facility as of December 31, 2019, with a leverage ratio of 5.66 to 1.00, a fixed charge coverage ratio of 2.70 to 1.00 and a senior secured leverage ratio of 0.94 to 1.00.

Interest expense related to our Credit Facility was \$6.9 million, \$4.3 million and \$1.6 million for the years ended December 31, 2017, 2018 and 2019, respectively. Amortization of debt issuance costs related to our Credit Facility was \$0.3 million, \$0.2 million and \$0.2 million for the years ended December 31, 2017, 2018 and 2019, respectively.

Acquisition debt consists of deferred purchase price and promissory notes payable to sellers. A majority of the deferred purchase price and notes bear no interest 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 \$0.9 million, \$0.8 million and \$0.6 million for the years ended December 31, 2017, 2018 and 2019, respectively.

The aggregate maturities of our long-term debt for the next five years subsequent to December 31, 2019 and thereafter are as follows (in thousands):

Years ending December 31,		
2020	\$	1,289
2021		1,023
2022		523
2023		84,363
2024		550
Thereafter		3,016
Total	\$	90,764

15. CONVERTIBLE SUBORDINATED NOTES

On March 19, 2014, we issued \$143.75 million aggregate principal amount of our 2.75% convertible subordinated notes due 2021 (“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 (the “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”).

On December 24, 2018, we completed privately-negotiated repurchases of an additional \$22.4 million in aggregate principal amount of Convertible Notes for \$22.9 million in cash (plus accrued interest of approximately \$0.2 million totaling \$23.0 million).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Following the Exchange and the December 2018 repurchases, the aggregate principal amount of our Convertible Notes outstanding was reduced to \$6.3 million.

For the year ended December 31, 2018, we recognized a net gain of \$1.7 million, recorded in *Net loss on early extinguishment of debt*, related to the Exchange and December 2018 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.

We incurred \$0.9 million in transactions costs related to the Exchange and December 2018 repurchases 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*.

On April 4, 2019, we completed a privately-negotiated repurchase of an additional \$25,000 in aggregate principal amount of Convertible Notes then outstanding for \$27,163.

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 2018, 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, 2019, the adjusted conversion rate of the Convertible Notes is 45.4615 shares of our common stock per \$1,000 principal amount of Convertible Notes, equivalent to an adjusted conversion price of \$22.00 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, 2019, 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, 2018 and 2019 are reflected on our Consolidated Balance Sheet as follows (in thousands):

	December 31, 2018	December 31, 2019
Long-term liabilities:		
Principal amount	\$ 6,346	\$ 6,319
Unamortized discount of liability component	(560)	(319)
Convertible Notes issuance costs, net of accumulated amortization of \$106 and \$130, respectively	(54)	(29)
Carrying value of the liability component	\$ 5,732	\$ 5,971
Carrying value of the equity component	\$ 789	\$ 789

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, 2018 and 2019.

The fair value of the Convertible Notes, which are Level 2 measurements, was \$7.8 million at December 31, 2019.

Interest expense on the Convertible Notes included contractual coupon interest expense of \$4.0 million, \$1.9 million and \$0.2 million for the years ended December 31, 2017, 2018 and 2019, respectively. Accretion of the discount on the Convertible Notes was \$4.3 million, \$2.2 million and \$0.2 million for the years ended December 31, 2017, 2018 and 2019, respectively. Amortization of debt issuance costs related to our Convertible Notes was \$517,000, \$245,000 and \$24,000 for the years ended December 31, 2017, 2018 and 2019, 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 14 month of the Convertible Notes. The effective interest rate on the unamortized debt discount for the years ended December 31, 2018 and 2019 was 11.3% and 11.4%, respectively. The effective interest rate on the debt issuance costs for both years ended December 31, 2018 and 2019 was 3.2%.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The aggregate maturities of our Convertible Notes for the five years subsequent to December 31, 2019 are as follows (in thousands):

	<u>Principal Maturity</u>	<u>Discount Amortization</u>	<u>Present Value</u>
Years ending December 31,			
2020	\$ —	\$ (270)	\$ (270)
2021	6,319	(49)	6,270
2022	—	—	—
2023	—	—	—
2024	—	—	—
Thereafter	—	—	—
Total	<u>\$ 6,319</u>	<u>\$ (319)</u>	<u>\$ 6,000</u>

16. SENIOR NOTES

On May 31, 2018, we issued \$325.0 million in aggregate principal amount of our Initial 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. We incurred \$1.4 million in debt issuance costs related to the Initial Senior Notes.

The Initial 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.

On December 19, 2019, we issued an additional \$75.0 million in aggregate principal amount of our Initial Senior Notes (the “Additional Senior Notes” and, together with the Initial Senior Notes, the “Senior Notes”) and related guarantees by the Subsidiary Guarantors in a private offering under Rule 144A and Regulation S of the Securities Act. The Additional Senior Notes were issued as additional securities under the Indenture.

We received proceeds of \$76.9 million, net of a debt premium of \$1.7 million (plus accrued interest of \$0.2 million). We incurred \$1.0 million in debt issuance costs related to the Additional Senior Notes. The additional issuance brings the total principal amount of the Senior Notes outstanding to \$400.0 million. The Senior Notes are treated as a single class of securities under the Indenture, and the Additional Senior Notes have identical terms to the Initial Senior Notes, except with respect to the date of issuance, the issue price, the initial interest accrual date and the initial interest payment date.

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 with respect to the Initial Senior Notes and June 1, 2020 with respect to the Additional Senior Notes 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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 carrying value of the Senior Notes at December 31, 2018 and December 31, 2019 are reflected in our Consolidated Balance Sheet as follows (in thousands):

	December 31, 2018	December 31, 2019
Long-term liabilities:		
Principal amount	\$ 325,000	\$ 400,000
Debt premium	—	1,688
Debt discount, net of accumulated amortization of \$273 and \$492, respectively	(4,602)	(4,110)
Debt issuance costs, net of accumulated amortization of \$77 and \$216, respectively	(1,290)	(2,131)
Carrying value of the Senior Notes	\$ 319,108	\$ 395,447

The fair value of the Senior Notes, which are Level 2 measurements, was \$426.4 million at December 31, 2019.

The debt discount, the debt premium and the debt issuance costs are being amortized using the effective interest method over the remaining term of approximately 77 months of the Senior Notes.

The effective interest rate on the unamortized debt discount and the unamortized debt issuance costs for the Initial Senior Notes for the year ended December 31, 2019 was 6.87% and 6.69%, respectively. The effective interest rate on the unamortized debt premium and the unamortized debt issuance costs for the Additional Senior Notes for the year ended December 31, 2019 was 6.20% and 6.88%, respectively.

Interest expense on the Senior Notes included contractual coupon interest expense of \$12.6 million and \$21.7 million for the years ended December 31, 2018 and 2019, respectively. Amortization of the debt discount on the Senior Notes was \$0.3 million and \$0.5 million for the years ended December 31, 2018 and 2019, respectively and amortization of debt issuance costs on the Senior Notes was \$0.1 million for the both the years ended December 31, 2018 and 2019.

The aggregate maturities of our Senior Notes for the five years subsequent to December 31, 2019 are as follows (in thousands):

	Principal Maturity	Discount Amortization	Premium Amortization	Present Value
Years ending December 31,				
2020	\$ —	\$ (528)	\$ 221	\$ (307)
2021	—	(565)	235	(330)
2022	—	(605)	250	(355)
2023	—	(648)	266	(382)
2024	—	(694)	283	(411)
Thereafter	400,000	(1,070)	433	399,363
Total	\$ 400,000	\$ (4,110)	\$ 1,688	\$ 397,578

17. LEASES

On January 1, 2019, we adopted Topic 842 using the modified retrospective method for all lease arrangements at the beginning of the period of adoption. Results for reporting periods beginning January 1, 2019 are presented under Topic 842, while prior period amounts have not been adjusted and continue to be reported in accordance with Topic 840. On January 1, 2019, we recorded operating lease right-of-use assets of \$16.5 million and operating lease liabilities of \$17.3 million, related to real estate and equipment leases, based on the present value of the future lease payments on the date of adoption.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The components of lease cost for the year ended December 31, 2019 are as follows (in thousands):

	Income Statement Classification	For The Year Ended, December 31, 2019
Operating lease cost	Facilities and grounds expense ⁽¹⁾	\$ 3,722
Short-term lease cost	Facilities and grounds expense ⁽¹⁾	277
Finance lease cost:		
Depreciation of leased assets	Depreciation and amortization ⁽²⁾	\$ 498
Interest on lease liabilities	<i>Interest expense</i>	520
Total finance lease cost		<u>1,018</u>
Total lease cost		<u>\$ 5,017</u>

- (1) Facilities and grounds expense is included within *Cost of service* and *General, administrative and other* on our Consolidated Statements of Operations.
- (2) Depreciation and amortization expense is included within *Field depreciation expense* and *Home office depreciation and amortization* on our Consolidated Statements of Operations.

Variable lease expense was immaterial for the year ended December 31, 2019.

Supplemental cash flow information related to our leases for the year ended December 31, 2019 is as follows (in thousands):

	For The Year Ended, December 31, 2019
Cash paid for operating leases included in operating activities	\$ 3,910
Cash paid for finance leases included in financing activities	872

Right-of-use assets obtained in exchange for new leases for the year ended December 31, 2019 are as follows (in thousands):

	For The Year Ended, December 31, 2019
Right-of-use assets obtained in exchange for new operating lease liabilities ⁽¹⁾	\$ 8,175
Right-of-use assets obtained in exchange for new finance lease liabilities	—

- (1) During the three months ended June 30, 2019, we modified an existing operating lease to extend the term through 2030. As a result of this modification, we increased our lease liabilities and right-of-use assets by \$8.2 million.

Supplemental balance sheet information related to leases as of December 31, 2019 is as follows (in thousands):

Lease Type	Balance Sheet Classification	December 31, 2019
Operating lease right-of-use assets	<i>Operating lease right-of-use assets</i>	\$ 22,304
Finance lease right-of-use assets ⁽¹⁾	<i>Property, plant and equipment, net</i>	5,204
Total right-of-use assets		<u>\$ 27,508</u>
Operating lease current liabilities	<i>Current portion of operating lease obligations</i>	\$ 1,554
Finance lease current liabilities	<i>Current portion of finance lease obligations</i>	290
Total current lease liabilities		<u>1,844</u>
Operating lease non-current liabilities	<i>Obligations under operating leases, net of current portion</i>	21,533
Finance lease non-current liabilities	<i>Obligations under finance leases, net of current portion</i>	5,854
Total non-current lease liabilities		<u>27,387</u>
Total lease liabilities		<u>\$ 29,231</u>

- (1) Finance lease right-of-use assets are presented net of accumulated depreciation of \$1.6 million.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The average lease terms and discount rates as of December 31, 2019 are as follows:

	Weighted-average remaining lease term (years)	Weighted-average discount rate
Operating leases	10.9	8.1%
Finance leases	7.0	8.2%

The aggregate future lease payments for operating and finance leases as of December 31, 2019 are as follows (in thousands):

	Operating	Finance
Lease payments due:		
2020	\$ 3,358	\$ 828
2021	3,705	836
2022	3,345	860
2023	3,249	860
2024	3,248	791
Thereafter	17,798	6,291
Total lease payments	\$ 34,703	\$ 10,466
Less: Interest	(11,616)	(4,322)
Present value of lease liabilities	\$ 23,087	\$ 6,144

As of December 31, 2019, we had no additional significant operating or finance leases that had not yet commenced.

At December 31, 2018, future minimum lease payments under non-cancelable lease agreements were as follows (in thousands):

	Future Minimum Lease Payments	
	Operating Leases	Finance Leases
Years ending December 31,		
2019	\$ 3,701	\$ 872
2020	3,171	821
2021	2,729	829
2022	519	853
2023	272	853
Thereafter	1,141	7,078
Total future minimum lease payments	\$ 11,533	\$ 11,306
Less: amount representing interest (rates ranging from 7.0% to 11.5%)		(4,851)
Less: current portion of obligations under finance leases		(312)
Long-term obligations under finance leases		\$ 6,143

18. COMMITMENTS AND CONTINGENCIES

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, 2019, 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 thousands):

	<u>Non-Compete</u>	<u>Consulting</u>	<u>Employment^(a)</u>	<u>Total</u>
Years ending December 31,				
2020	\$ 2,135	\$ 869	\$ 3,482	\$ 6,486
2021	1,905	663	3,482	6,050
2022	1,465	404	3,077	4,946
2023	993	162	777	1,932
2024	665	20	648	1,333
Thereafter	927	—	—	927
Total	<u>\$ 8,090</u>	<u>\$ 2,118</u>	<u>\$ 11,466</u>	<u>\$ 21,674</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.

401(K) Plan

We sponsor a defined contribution plan (401K) for the benefit of our employees. Matching contributions and plan administrative expenses totaled \$1.9 million, \$2.1 million and \$2.0 million during the years ended December 31, 2017, 2018 and 2019, 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 and was approved by the Court in October 2019. We paid \$0.7 million under the settlement agreement in November 2019.

19. INCOME TAXES

The provision (benefit) for income taxes for the years ended December 31, 2017, 2018 and 2019 consisted of the following (in thousands):

	<u>Years Ended December 31,</u>		
	<u>2017</u>	<u>2018</u>	<u>2019</u>
Current:			
U. S. federal provision (benefit)	\$ 6,425	\$ 1,489	\$ (2,039)
State provision (benefit)	815	1,309	(195)
Total current provision (benefit)	<u>\$ 7,240</u>	<u>\$ 2,798</u>	<u>\$ (2,234)</u>
Deferred:			
U. S. federal provision (benefit)	\$ (12,881)	\$ 2,831	\$ 8,056
State provision	1,230	992	2,061
Total deferred provision (benefit)	<u>\$ (11,651)</u>	<u>\$ 3,823</u>	<u>\$ 10,117</u>
Total income tax provision (benefit)	<u>\$ (4,411)</u>	<u>\$ 6,621</u>	<u>\$ 7,883</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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, 2017, 2018 and 2019 is as follows (dollars in thousands):

	Years Ended December 31,					
	2017		2018		2019	
	Amount	Percent	Amount	Percent	Amount	Percent
Federal statutory rate	\$ 11,474	35.0 %	\$ 3,834	21.0 %	\$ 4,707	21.0 %
Effect of state income taxes, net of federal benefit	1,304	4.0	1,776	9.7	1,352	6.0
Effect of non-deductible expenses and other, net	(36)	(0.1)	1,451	7.9	947	4.2
Effect of divestiture and impairment of business	—	—	—	—	911	4.1
Change in valuation allowance	23	0.1	26	0.1	(34)	(0.2)
Re-measurement of deferred taxes due to tax reform	(17,176)	(52.4)	(466)	(2.5)	—	—
Total	\$ (4,411)	(13.5) %	\$ 6,621	36.2 %	\$ 7,883	35.1 %

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 examination was still ongoing as of December 31, 2019. The federal statute of limitations remains open for our tax years from 2015 through 2018.

The tax effects of temporary differences from total operations that give rise to significant deferred tax assets and liabilities at December 31, 2018 and 2019 are as follows (in thousands):

	Years Ended December 31,	
	2018	2019
Deferred income tax assets:		
Net operating loss carryforwards	\$ 1,569	\$ 3,602
Interest expense limitation	996	4,190
Tax credit carryforwards	133	100
State bonus depreciation	970	1,124
Accrued liabilities and other	5,493	5,124
Amortization of non-compete agreements	1,135	1,104
Preneed liabilities	4,242	—
Total deferred income tax assets	14,538	15,244
Less valuation allowance	(276)	(234)
Total deferred income tax assets	\$ 14,262	\$ 15,010
Deferred income tax liabilities:		
Depreciation and amortization	\$ (45,150)	\$ (49,568)
Preneed liabilities	—	(6,446)
Convertible subordinated notes due 2021	(131)	(75)
Prepays and other	(244)	(289)
Total deferred income tax liabilities	(45,525)	(56,378)
Total net deferred tax liabilities	\$ (31,263)	\$ (41,368)

Our deferred tax assets and liabilities, along with related valuation allowances are classified as non-current on our Consolidated Balance Sheet at December 31, 2018 and 2019.

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 decrease in our valuation allowance during 2019.

For federal income tax reporting purposes, we have net operating loss carryforwards of \$7.2 million with an indefinite life that will not expire. For state reporting purposes, we have \$45.8 million of net operating loss carryforwards that will expire between 2020 and 2038, if not utilized. Based on management's assessment of the various state net operating losses, it was determined that

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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, 2019 was attributable to the deferred tax asset related to a portion of the state operating losses.

The federal and state net operating loss (NOL) carryforwards in the income tax returns filed included unrecognized tax benefits.

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. The deferred tax assets recognized for those NOLs are presented net of these unrecognized tax benefits.

At December 31, 2019, the Company's unrecognized tax benefits reserve for uncertain tax positions primarily relates to pending accounting method changes filed for the tax year ending December 31, 2018. In 2018, we filed two Form 3115s, Application for Change in Accounting Method, and associated statements to request consent to change the method of accounting for deferred revenue for our cemetery property and cemetery merchandise and service operations for the tax year beginning January 1, 2018. These method changes are still under review. The amount of the reserve recorded as of December 31, 2019 was \$0.7 million. No reserve was recorded at December 31, 2018.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	Years Ended December 31,		
	2017	2018	2019
Unrecognized tax benefit at beginning of year	\$ —	\$ —	\$ —
Gross increases - tax positions in prior period	—	—	691
Gross decreases - tax positions in prior period	—	—	—
Gross increases - tax positions in current period	—	—	—
Settlement	—	—	—
Unrecognized tax benefit at end of year	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 691</u>

There are no balances included in unrecognized tax benefits that, if recognized, would affect the effective tax rate. We believe that it is reasonably possible that a decrease of the entire unrecognized tax benefit may be recognized within the next 12 months.

On December 31, 2019, pursuant to the Transactions Agreement dated November 25, 2019 with Calvary Memorial Park, Inc. and Fairfax Memorial Funeral Home, LLC ("the Agreement"), all of the outstanding equity interests of the Fairfax, Virginia funeral and cemetery combination businesses were acquired for \$102.0 million in cash. The funeral home business was operated by a limited liability company that was treated as a partnership for federal tax purposes prior to the acquisition date, and therefore, the acquisition of all of the outstanding membership units of the partnership were treated as an asset acquisition. The cemetery business was operated by an S corporation prior to the acquisition date, and therefore, consent was obtained from the selling S corporation shareholders to make a 338(h)(10) election under the Internal Revenue Code, which allowed us to treat the acquisition of the stock of the cemetery business as an asset acquisition and allowed us to record the assets and liabilities at fair value. Therefore, no deferred taxes have been recorded.

See Note 3 to the Consolidated Financial Statements included herein, for a additional information regarding the Fairfax, Virginia acquisition.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

20. STOCKHOLDERS' EQUITY

Share Authorization

We are authorized to issue 80,000,000 shares of common stock, \$0.01 per share par value. We had 25,703,490 and 25,880,362 shares issued and outstanding, net of 7,625,339 and 8,025,339 shares held in treasury at par, at December 31, 2018 and 2019, respectively.

Stock Based Compensation Plans

During the year ended December 31, 2019, 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, 2019 is as follows (shares in thousands):

	<u>Shares Reserved</u>	<u>Shares Available to Issue</u>	<u>Options Outstanding</u>	<u>Performance Awards Outstanding ⁽²⁾</u>
Amended and Restated 2006 Plan	—	—	844	—
2017 Plan	2,801 ⁽¹⁾	1,848	234	569
Total	<u>2,801</u>	<u>1,848</u>	<u>1,078</u>	<u>569</u>

(1) Amount includes approximately 1,246,000 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.

(2) Performance Awards are reserved at 200% of shares granted which is equal to the maximum payout in shares.

Restricted Stock

During 2019, we issued restricted stock to certain employees totaling 25,550 shares that vest over a three year period and had an aggregate grant date market value of \$0.5 million. In 2018, a total of 86,260 shares of restricted stock were awarded with a 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.

A summary of the status of unvested restricted stock as of December 31, 2019, and changes during 2019, 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, 2019	89	\$ 25.38
Awards	26	19.94
Vestings	(33)	25.19
Cancellations	(12)	24.84
Unvested at December 31, 2019	<u>70</u>	<u>\$ 23.56</u>

We recorded stock-based compensation expense, which is included in *General, administrative and other* expenses, for restricted stock awards of \$0.7 million, \$0.8 million and \$0.8 million the years ended December 31, 2017, 2018 and 2019, respectively.

As of December 31, 2019, we had \$1.6 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 1.4 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Stock Options

During 2019, we granted 100,000 options to a certain key employee at a weighted average exercise price of \$24.35. 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 \$0.6 million. In 2018, a total of 212,940 stock options were awarded, the fair value of which was \$1.4 million. In 2017, a total of 461,700 stock options were awarded, the fair value of which was \$3.3 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 and outstanding under this plan have either a seven or ten-year term. 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, 2017, 2018 and 2019:

	2017	2018	2019
Dividend yield	0.75%	1.18%	1.23%
Expected volatility	29.29%	27.08%	27.45%
Risk-free interest rate	1.95%	2.65%	1.65%
Expected holding period (years)	5.0	5.0	5.0

A summary of the stock options at December 31, 2017, 2018 and 2019 and changes during the three years ended December 31, 2019 is presented in the table and narrative below (shares in thousands):

	Years Ended December 31,					
	2017		2018		2019	
	Shares	Wtd. Avg. Ex. Price	Shares	Wtd. Avg. Ex. Price	Shares	Wtd. Avg. Ex. Price
Outstanding at beginning of period	1,650	\$ 19.18	1,934	\$ 20.85	1,523	\$ 21.95
Granted	462	\$ 26.56	213	\$ 25.43	100	\$ 24.35
Exercised	(159)	\$ 19.81	(459)	\$ 17.73	(247)	\$ 17.37
Canceled or expired	(19)	\$ 23.17	(165)	\$ 25.34	(298)	\$ 21.96
Outstanding at end of year	1,934	\$ 20.85	1,523	\$ 21.95	1,078	\$ 23.22
Exercisable at end of year	1,225	\$ 18.68	1,001	\$ 20.29	643	\$ 22.02

The aggregate intrinsic value of the outstanding and exercisable stock options was \$2.9 million and \$2.4 million at December 31, 2019. The total intrinsic value of options exercised during the years ended December 31, 2017, 2018 and 2019 totaled \$1.0 million, \$3.9 million and \$1.2 million, respectively.

The total fair value of stock options vested during 2017, 2018 and 2019 totaled \$1.5 million, \$1.5 million and \$0.9 million, respectively. We recorded stock-based compensation expense, which is included in *General, administrative and other* expenses, for stock options of \$1.5 million, \$1.0 million and \$0.7 million for the years ended December 31, 2017, 2018 and 2019, respectively.

As of December 31, 2019, there was \$1.9 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 3.02 years.

The following table further describes our outstanding stock options at December 31, 2019:

	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/19	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at 12/31/19	Weighted-Average Exercise Price
Actual Ranges of Exercise Prices					
\$5.70 - \$5.94	43,871	1.69	\$ 5.82	43,871	\$ 5.82
\$20.06 - \$22.58	495,320	3.25	\$ 21.89	84,240	\$ 20.06
\$24.35 - \$26.93	538,944	7.95	\$ 25.86	514,612	\$ 23.72
\$5.70 - \$26.93	1,078,135	5.54	\$ 23.22	642,723	\$ 22.02

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Performance Awards

During 2019, we granted 306,623 performance awards to our leadership team and certain key employees, payable in shares. These awards will vest (if at all) in December 2023, provided that certain criteria surrounding our common stock price is achieved. The fair value of these performance awards was \$1.6 million and was determined by using the Monte-Carlo simulation pricing model with the following assumptions:

Grant date	February 20, 2019	August 1, 2019	November 4, 2019	December 2, 2019
Performance period	February 20, 2019 - December 31, 2023	August 1, 2019 - December 31, 2023	November 4, 2019 - December 31, 2023	December 2, 2019 - December 31, 2023
Shares granted	248,500	14,000	9,123	35,000
Simulation period (years)	4.86	4.42	4.16	4.08
Expected volatility	25.7%	27.01%	28.39%	28.47%
Risk-free interest rate	2.47%	1.68%	1.6%	1.64%
Forfeiture rate	7.17%	7.17%	7.17%	7.17%

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 weighted average 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 approximately \$2.8 million and was determined by using the weighted average stock price on the grant date of \$26.56.

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 \$0.7 million, \$4.4 million and \$0.2 million during the years ended December 31, 2017, 2018 and 2019, 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 2019, employees purchased a total of 73,731 shares at a weighted average price of \$13.18 per share. 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.

We recorded stock-based compensation expense, which is included in *General, administrative and other* expenses, for our ESPP of approximately \$0.2 million, \$0.2 million and \$0.3 million during the years ended December 31, 2017, 2018 and 2019, respectively.

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:

	2017	2018	2019
Dividend yield	0.9%	1.4%	1.4%
Expected volatility	19%	21%	36%
Risk-free interest rate	0.53%, 0.65%, 0.77%, 0.89%	1.44%, 1.61%, 1.72%, 1.83%	2.42%, 2.51%, 2.56%, 2.60%
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).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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, 2019, we granted 7,458 shares of our common stock to two Directors, which were valued at \$0.2 million at a weighted average stock price of \$20.78.

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, \$0.5 million and \$0.5 million during the years ended December 31, 2017, 2018 and 2019, respectively.

Cash Dividends

For the years ended December 31, 2018 and 2019, our Board declared the following dividends payable on the dates below (in thousands, except per share amounts):

<u>2019</u>	<u>Per Share</u>	<u>Dollar Value</u>
March 1st	\$ 0.075	\$ 1,360
June 1st	\$ 0.075	\$ 1,365
September 1st	\$ 0.075	\$ 1,336
December 1st	\$ 0.075	\$ 1,337
<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

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, 2018	\$ —
Decrease in net unrealized gains associated with available-for-sale securities of the trusts	5
Reclassification of net unrealized gain activity attributable to the <i>Deferred preneed funeral and cemetery receipts held in trust and Care trusts' corpus</i>	(5)
Balance at December 31, 2019	<u>\$ —</u>

21. 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 bringing the total authorized repurchase amount to \$40.0 million. On July 31, 2019, our Board approved an additional \$25.0 million for repurchases of our common stock in accordance with the Exchange Act.

During the year ended December 31, 2019, we repurchased 400,000 shares of common stock for a total cost of \$7.8 million at an average cost of \$19.39 per share pursuant to our share repurchase program. 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. 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, 2019, we had approximately \$25.6 million available for repurchase under our share repurchase program.

22. 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, 2017, 2018 and 2019 (in thousands, except per share data):

	Years Ended December 31,		
	2017	2018	2019
Numerator for basic and diluted earnings per share:			
Net income	\$ 37,193	\$ 11,645	\$ 14,533
Less: Earnings allocated to unvested restricted stock	(135)	(57)	(62)
Income attributable to common stockholders	<u>\$ 37,058</u>	<u>\$ 11,588</u>	<u>\$ 14,471</u>
Denominator:			
Denominator for basic earnings per common share - weighted average shares outstanding	16,438	17,971	17,877
Effect of dilutive securities:			
Stock options	336	66	118
Convertible subordinated notes	941	337	10
Denominator for diluted earnings per common share - weighted average shares outstanding	<u>17,715</u>	<u>18,374</u>	<u>18,005</u>
Basic earnings per common share	<u>\$ 2.25</u>	<u>\$ 0.64</u>	<u>\$ 0.81</u>
Diluted earnings per common share	<u>\$ 2.09</u>	<u>\$ 0.63</u>	<u>\$ 0.80</u>

The fully diluted weighted average shares outstanding for the years ended December 31, 2017, 2018 and 2019, and the corresponding calculation of fully diluted earnings per share, included 941,000, 337,000 and 10,000 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, 2018 and 2019, there were 354,000, 1,661,000 and 338,000 stock options excluded from the computation of diluted earnings per share because the inclusion of such stock options would result in an antidilutive effect.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

23. 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:				
2019	\$ 216,868	\$ 57,239	\$ —	\$ 274,107
2018	210,725	57,267	—	267,992
2017	200,886	57,253	—	258,139
Operating income (loss):				
2019	\$ 63,602	\$ 15,983	\$ (27,296)	\$ 52,289
2018	60,881	15,066	(32,640)	43,307
2017	61,369	15,430	(27,858)	48,941
Income (loss) before income taxes:				
2019	\$ 58,844	\$ 16,025	\$ (52,453)	\$ 22,416
2018	59,912	15,349	(56,995)	18,266
2017	60,634	15,852	(43,704)	32,782
Depreciation and amortization:				
2019	\$ 11,128	\$ 5,227	\$ 1,416	\$ 17,771
2018	10,726	4,891	1,813	17,430
2017	9,785	4,589	1,605	15,979
Interest expense:				
2019	\$ 1,142	\$ —	\$ 24,380	\$ 25,522
2018	1,339	—	19,770	21,109
2017	1,170	2	11,776	12,948
Income tax expense (benefit):				
2019	\$ 20,694	\$ 5,635	\$ (18,446)	\$ 7,883
2018	21,717	5,564	(20,660)	6,621
2017	(8,159)	(2,133)	5,881	(4,411)
Total assets:				
2019	\$ 790,459	\$ 314,413	\$ 24,883	\$ 1,129,755
2018	686,470	226,475	4,557	917,502
2017	665,483	251,243	4,807	921,533
Long-lived assets:				
2019	\$ 650,179	\$ 145,158	\$ 1,303	\$ 796,640
2018	572,916	89,654	1,538	664,108
2017	537,282	90,292	2,124	629,698
Capital expenditures:				
2019	\$ 8,403	\$ 5,772	\$ 1,204	\$ 15,379
2018	8,296	3,989	1,241	13,526
2017	9,835	5,283	1,277	16,395
Number of operating locations at year end:				
2019	186	31	—	217
2018	182	29	—	211
2017	178	32	—	210

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

24. SUPPLEMENTARY DATA

Balance Sheet

The detail of certain balance sheet accounts as of December 31, 2018 and 2019 is as follows (in thousands):

	December 31,	
	2018	2019
Prepays and other current assets:		
Prepaid expenses	\$ 1,456	\$ 1,596
Deposit on pending acquisition	—	5,000
Federal income tax receivable	923	2,973
State income tax receivable	422	986
Other current assets	210	112
Total other current assets	<u>\$ 3,011</u>	<u>\$ 10,667</u>
Accrued and other liabilities:		
Accrued salaries and wages	\$ 4,088	\$ 4,323
Accrued incentive compensation	7,395	9,199
Accrued vacation	2,358	2,880
Accrued insurance	3,188	2,329
Accrued interest	1,856	2,299
Accrued ad valorem and franchise taxes	904	678
Accrued commissions	441	560
Perpetual care trust taxes payable	962	401
Deferred rent	274	—
Other accrued liabilities	1,178	1,357
Total accrued and other liabilities	<u>\$ 22,644</u>	<u>\$ 24,026</u>
Other long-term liabilities:		
Deferred rent	\$ 692	\$ —
Incentive compensation	1,563	1,267
Contingent consideration	878	470
Total other long-term liabilities	<u>\$ 3,133</u>	<u>\$ 1,737</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

25. QUARTERLY FINANCIAL DATA (UNAUDITED)

The tables below set forth consolidated operating results by fiscal quarter for the years ended December 31, 2018 and 2019 (in thousands, except earnings per share):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2019				
Revenue	\$ 69,081	\$ 67,752	\$ 66,125	\$ 71,149
Gross profit	21,600	19,250	18,056	20,679
Net income	<u>\$ 6,525</u>	<u>\$ 4,862</u>	<u>\$ 577</u>	<u>\$ 2,569</u>
Basic earnings per common share: (a)	\$ 0.36	\$ 0.27	\$ 0.03	\$ 0.14
Diluted earnings per common share: (a)	\$ 0.36	\$ 0.27	\$ 0.03	\$ 0.14
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)

(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 2018 and 2019 due to rounding.

26. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

The following information is supplemental disclosure for the Consolidated Statements of Cash Flows (in thousands):

	Years Ended December 31,		
	2017	2018	2019
Cash paid for interest and financing costs	\$ 11,092	\$ 18,858	\$ 23,870
Cash paid for taxes	\$ 5,902	\$ 3,543	\$ 378
Fair value of stock, stock options and performance awards issued to directors, officers, and certain other employees	\$ 6,854	\$ 6,563	\$ 2,855

27. SUBSEQUENT EVENTS

On January 3, 2020, we acquired a funeral home and cemetery combination business in Lafayette, California for \$33.0 million in cash. The consideration for this acquisition was funded through borrowings under our Credit Facility.

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, 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
Year ended December 31, 2019:				
Allowance for bad debts, current portion	\$ 769	\$ 1,088	\$ 1,008	\$ 849
Allowance for receivables from preneed funeral and cemetery trusts and contract cancellations, non-current portion	\$ 2,151	\$ 532	\$ 457	\$ 2,226
Employee severance accruals	\$ 1,141	\$ 1,265	\$ 1,569	\$ 837
Valuation allowance of the deferred tax asset	\$ 276	\$ —	\$ 43	\$ 233

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, 2019 (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, 2019 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, 2019.

The Company's internal control over financial reporting as of December 31, 2019 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, 2019, 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, Chief Accounting Officer and Secretary
(Principal Financial Officer)

February 28, 2020

Changes in Internal Control Over Financial Reporting

During the three months ended December 31, 2019, 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 in this Annual Report on Form 10-K by reference to our definitive proxy statement or an amendment to this Annual Report on Form 10-K to be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year ended December 31, 2019.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by Item 11 is incorporated in this Annual Report on Form 10-K by reference to our definitive proxy statement or an amendment to this Annual Report on Form 10-K to be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year ended December 31, 2019.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The information required by Item 12 is incorporated in this Annual Report on Form 10-K by reference to our definitive proxy statement or an amendment to this Annual Report on Form 10-K to be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year ended December 31, 2019.

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, 2019.

<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	1,078,135	\$ 23.22	1,847,655
Equity compensation plans not approved by security holders	—	—	—
Total	<u>1,078,135</u>	<u>\$ 23.22</u>	<u>1,847,655</u>

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.

The information required by Item 13 is incorporated in this Annual Report on Form 10-K by reference to our definitive proxy statement or an amendment to this Annual Report on Form 10-K to be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year ended December 31, 2019.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by Item 14 is incorporated in this Annual Report on Form 10-K by reference to our definitive proxy statement or an amendment to this Annual Report on Form 10-K to be filed with the Securities and Exchange Commission not later than 120 days after the end of the fiscal year ended December 31, 2019.

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	45
Consolidated Balance Sheet as of December 31, 2018 and 2019	47
Consolidated Statements of Operations for the Years Ended December 31, 2017, 2018 and 2019	48
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2017, 2018 and 2019	49
Consolidated Statements of Cash Flows for the Years Ended December 31, 2017, 2018 and 2019	50
Notes to Consolidated Financial Statements	51
Management's Report on Internal Control over Financial Reporting	98

(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	96

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 2020 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 3.1 to the Company's Current Report on Form 8-K filed May 28, 2008.
- 3.7 Second Amendment to the Amended and Restated Bylaws of Carriage Services, Inc. Incorporated by reference to Exhibit 3.1 to the Company's Current report on Form 8-K filed March 8, 2019.
- 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. †
- *4.10 Summary of Securities Registered under Section 12.
- 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 America, 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 Amendment to Credit Agreement dated as of July 31, 2019, 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 July 31, 2019.
- 10.13 Third Amendment to Credit Agreement dated as of December 19, 2019, 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 December 19, 2019.
- 10.14 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. †
- 10.15 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. †
- 10.16 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. †
- 10.17 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. †
- 10.18 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. †
- 10.19 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. †
- 10.20 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. †
- 10.21 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. †

- 10.22 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. †
- 10.23 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. †
- 10.24 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. †
- 10.25 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. †
- 10.26 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. †
- 10.27 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. †
- 10.28 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. †
- 10.29 Release and Separation Agreement by and between Carriage Services, Inc. and Mark R. Bruce, dated effective November 1, 2018. Incorporated by reference to Exhibit 10.36 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2018. †
- 10.30 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. †
- 10.31 Employment Agreement dated November 5, 2019, by and between the Company and Melvin C. Payne. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 8, 2019. †
- 10.32 Employment Agreement dated November 5, 2019, by and between the Company and Shawn Phillips. Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on November 8, 2019. †
- 10.33 Employment Agreement dated November 5, 2019, by and between the Company and Paul Elliot. Incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on November 8, 2019. †
- 10.34 Employment Agreement dated November 5, 2019, by and between the Company and Viki K. Blinderman. Incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on November 8, 2019. †
- 10.35 Employment Agreement dated November 5, 2019, by and between the Company and Carl Benjamin Brink. Incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on November 8, 2019. †
- 10.36 Employment Agreement dated December 1, 2019, by and between Carriage Services, Inc. and William W. Goetz. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 2, 2019. †

- 10.37 Form of Performance Award Agreement under Carriage Services, Inc. 2017 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 25, 2020. †
- *10.38 Transaction Agreement dated as of November 25, 2019 by and among Carriage Funeral Holdings, Inc., Carriage Holdings Virginia, Inc., Carriage Services of Virginia LLC, Calvary Memorial Park, Inc., Fairfax Memorial Funeral Home, L.L.C., Holder Representative and Carriage Services, Inc. ++
- *10.39 Amendment to the Transaction Agreement dated as of December 30, 2019 by and among Carriage Funeral Holdings, Inc., Carriage Holdings Virginia, Inc., Carriage Services of Virginia LLC, Calvary Memorial Park, Inc., Fairfax Memorial Funeral Home, L.L.C., Holder Representative and Carriage Services, Inc.
- *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.

(++) Portions of this exhibit have been redacted in accordance with Item 601(b)(10) of Regulation S-K.

ITEM 16. FORM 10-K SUMMARY.

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on February 28, 2020.

CARRIAGE SERVICES, INC.

By: /s/ Melvin C. Payne
Melvin C. Payne
Chief Executive Officer and Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Melvin C. Payne</u> Melvin C. Payne	Chief Executive Officer and Chairman of the Board (Principal Executive Officer)	February 28, 2020
<u>/s/ Viki K. Blinderman</u> Viki K. Blinderman	Senior Vice President, Chief Accounting Officer, Principal Financial Officer and Secretary (Principal Financial Officer)	February 28, 2020
<u>/s/ Adeola Olaniyan</u> Adeola Olaniyan	Corporate Controller and Principal Accounting Officer	February 28, 2020
<u>/s/ William W. Goetz</u> William W. Goetz	President, Chief Operating Officer and Director	February 28, 2020
<u>/s/ Donald D. Patteson Jr.</u> Donald D. Patteson Jr.	Director	February 28, 2020
<u>/s/ James R. Schenck</u> James R. Schenck	Director	February 28, 2020
<u>/s/ Barry K. Fingerhut</u> Barry K. Fingerhut	Director	February 28, 2020
<u>/s/ Bryan D. Leibman</u> Bryan D. Leibman	Director	February 28, 2020
<u>/s/ Douglas Meehan</u> Douglas Meehan	Director	February 28, 2020

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CORPORATE INFORMATION

Carriage Services is a leading provider of funeral and cemetery services and merchandise in the United States. As of December 31, 2019, Carriage operated 186 funeral homes in 29 states and 31 cemeteries in 11 states.

BOARD OF DIRECTORS

Melvin C. Payne

Chief Executive Officer and
Chairman of the Board

William W. Goetz

President and Chief Operating Officer

Bryan D. Leibman

President and Chief Executive Officer,
Frosch Travel

Barry K. Fingerhut

Chief Executive Officer,
Certification Partners, LLC

Douglas B. Meehan

Deputy Chief Investment Officer,
van Biema Value Partners, LLC

Donald D. Patteson, Jr.

Investor

James R. Schenck

President and Chief Executive Officer,
PenFed Credit Union

ADVISOR TO THE BOARD OF DIRECTORS

Gregory R. Brudnicki

Mayor of Panama City, Florida

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, 2019 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

EXECUTIVE TEAM

Melvin C. Payne

Chief Executive Officer and
Chairman of the Board

William W. Goetz

President and Chief Operating Officer

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

Paul D. Elliott

Senior Vice President and Regional Partner

Michael S. Loeffel

Senior Vice President of Human Resources

Christopher Manceaux

Senior Vice President and Regional Partner

Steven D. Metzger

Senior Vice President and General Counsel

Shawn R. Phillips

Senior Vice President, Regional Partner and Head
of Strategic and Corporate Development

Peggy Schappaugh

Vice President of Operations and
Acquisitions Analysis

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, 2019, 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