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CSV - Q1 2018 Carriage Services Inc Earnings Call

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CORPORATE PARTICIPANTS

Carl Benjamin Brink *Carriage Services, Inc. - CFO, Senior VP & Treasurer*

Mark R. Bruce *Carriage Services, Inc. - COO & Senior VP*

Melvin C. Payne *Carriage Services, Inc. - Founder, Executive Chairman & CEO*

Viki King Blinderman *Carriage Services, Inc. - Principal Financial Officer, CAO, Senior VP & Secretary*

CONFERENCE CALL PARTICIPANTS

Christopher Huang Howe *Barrington Research Associates, Inc., Research Division - Research Analyst*

Christopher Paul McGinnis *Sidoti & Company, LLC - Special Situations Equity Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Carriage Services First Quarter 2018 Earnings Conference Call. (Operator Instructions)

Please note that this event is being recorded. I would now like to turn the conference over to Viki Blinderman, Senior Vice President and Principal Financial Officer. Please go ahead.

Viki King Blinderman - *Carriage Services, Inc. - Principal Financial Officer, CAO, Senior VP & Secretary*

Thank you, and good morning, everyone. I'd like to welcome you to our Carriage Services First Quarter Conference Call. Today we'll be discussing the company's results after the first quarter '18, which was released yesterday after the market closed. Carriage Services has posted a press release including supplemental financial tables and information on its investor's page of our website. The IR conference is being recorded and an archive will be made available on our website later today to April 30. Replay information for the call can be found in the press release distributed yesterday. On the call today for management are: Mel Payne, Chairman and Chief Executive Officer; Mark Bruce, Chief Operating Officer; and Ben Brink, Chief Financial Officer.

Today's call will begin with formal remarks from management followed by a question-and-answer period. Please note that during the call, we will make forward-looking statements in accordance with the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. I'd like to call your attention to the risks associated with these statements, which are more fully described in the company's report filed on Form 10-K and other filings with the SEC.

Forward-looking statements, assumptions or factors stated or referred to on this conference call are based on information available to Carriage Services as of today. Carriage Services expressly disclaims any duty to provide update to these forward-looking statements, assumptions or other factors after the date of this call to reflect the occurrence of events, circumstances or changes in expectations. In addition, during the course of the morning's call, we will reference certain non-GAAP financial performance measures. Management's opinion regarding the usefulness of such measures together with the reconciliation of such measures to the most directly comparable GAAP measures for historical periods are included in the press release and the company's filings with the SEC. Now I'd like to turn the call over to Ben.

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, Senior VP & Treasurer*

Thank you, Viki, and thanks to everyone that is joined us on the call today. Carriage Services record first quarter results were reflective of the hard work and dedication of our managing partners and their teams across our organization. High-performance execution across our funeral home and cemetery businesses and above-average death rate in January and a full quarter results of the high-quality acquisitions we made in the fourth



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quarter of last year led to a year-over-year revenue increase of 7.7%. Particularly impressive with the 4% and 8% year-over-year increase in revenue in our same-store funeral and cemetery segments respectively. Overhead spending for the quarter was essentially flat year-over-year, but overhead as a percentage of revenue fell 120 basis points to 12%. This is an important metric within Carriage to measure the improvement and effectiveness of our best-in-class support and consolidation platform.

As we move forward for the rest of the year, we expect total overhead spending to be roughly in line with 2017 and overhead as a percentage of revenue to continue to fall. The increase in both revenue and field EBITDA and the decrease in overhead as a percentage of revenue were leveraged into a year-over-year increase of 9.2% in consolidated EBITDA and a 40 basis point improvement in consolidated EBITDA margin to 30.6%. Adjusted diluted earnings per share was \$0.59 for the first quarter, which was a 31.1% increase from the first quarter of last year. The year-over-year increase in adjusted diluted EPS was driven by the broad execution across our businesses and a lower federal tax rate. Our effective tax rate for the quarter was 23.5% compared to 40% last year. Going forward, we expect our GAAP tax rate to be 27.5% with cash taxes paid representing 80% of that rate. Free cash flow for the first quarter more than doubled year-over-year from \$6.4 million to \$13.4 million, primarily due to improved operational performance. Free cash flow also benefited from lower estimated tax payments, lower severance expense and a reduced payment for our Good to Great long-term incentive program. This strong free cash flow generation allowed Carriage to reduce overall debt outstanding by \$12 million in the quarter. Total debt outstanding as of the end of the quarter was approximately \$371 million. Our pro forma total debt to adjusted EBITDA leverage ratio as defining our credit agreement stood at 4.85x at the end of the first quarter.

As we have previously stated, we are comfortable operating our business between 4x and 5x leverage. We expect that our leverage ratio will approach 4.5x at the end of the year and a longer-term expectation is to operate within a range of 4x to 4.5x. These leverage ratio targets can be achieved even as we execute on our strategic acquisition model, given the free cash flow generation characteristics of Carriage, and the fact that we finance the majority of our acquisition activity at a free cash flow. We are lowering a Roughly Right Rolling Four Quarter Outlook for adjusted diluted EPS to a range of \$1.80 to \$1.85. The reduction was entirely due to an acquisition, which shows not to complete in the first quarter, higher-expected interest expense on our floating-rate debt, and an increase in the diluted shares outstanding attributable to our 2.75% convertible notes. Overall we feel really good about the quarter and are excited to report our results throughout the rest of the year. And with that I'll turn the call over to Mark to discuss our operational results.

Mark R. Bruce - *Carriage Services, Inc. - COO & Senior VP*

Thank you, Ben. As Ben shared the consolidated results for the 3 months ending March 31, 2018, were very good. And we continue to be encouraged by the underlying trends throughout same-store funeral and the improvements in our cemetery sales and acquired funeral portfolios. So let me share some color. Same-store funeral operations. As we previously shared, the main focus of our Standards Operating Model is to grow same-store funeral contract volumes, which are the number of families served in a particular business. We place the most emphasis on the standard and it is weighted to 30% out of 100% of possible standards achievement because volume growth positively drives operating leverage and leaves to a higher growth and field EBITDA dollars and margin.

For the 3 months ending March 31, 2018, we increased same-store funeral field contract volumes by 3.4%, revenue by 4% and EBITDA by 2.9%. We continue to be encouraged by the operating improvements of the same-store funeral businesses in the 10 markets that we declustered. That's where we added a managing partner into our business and they have been part of a group of 2 or more businesses and previously led by a single managing partner. The decision to decluster businesses that is to introduce a managing partner into more businesses, it had the expected impact in the short term to missing salary and benefits and EBITDA standards. So we continue to see growth in contract volumes, revenue, and EBITDA trending over time to be consistent with our expectations for high performance as demonstrated in the most recent period.

Acquired funeral operations. Overall acquired funeral operations performance was good and the 3 businesses we focused on throughout 2017 continue to improve. As we've previously shared, it takes time for local leaders to internalize, practice and continuously improve as our performance is now being measured against high-performing peers being the best standards performance. This is why we hold acquired funeral businesses separate for 5 years, while the typically long process of full integration occurs before moving them into the same-store funeral portfolio. With the 3 months ending March 31, 2018, we saw very positive trends in acquired funeral contract volumes, revenues and EBITDA, with field EBITDA margins of 39.8% in 2018 compared to 43.1% in 2017. The delta between 2018 and 2017 is simply the comparison of high performance in 2018 versus record performance in 2017.



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The good news with our acquired funeral businesses is that there's nothing to fix here. As we've shared in previous communications and most recently in our 2017 shareholder letter, we understand that it takes many years for businesses to achieve their full steady-state earnings power potential after initial integration into the framework of our Standards Operating Model. And short-term performance variations are to be expected as part of the integration to our High Performance Culture Framework. We continue to be encouraged by improving performance trends throughout our acquired funeral portfolio and expect continued high performance.

Cemetery sales. There was much more work to do, we continue to be encouraged by the performance improvements of our cemetery sales teams. For the 3 months ending March 31, 2018, same-store cemetery revenue increased 8.1%, and field EBITDA 14.1%. As always, we focus on first two than what, and we've added more cemetery sale leadership talent throughout the company and expect recent performance trends to continue.

Now, as this is our custom it's my honor to announce our high-performance heroes. Andrew Cumby, Cumby Funeral Home, High Point, North Carolina; Jason Higginbotham, Lakeland Funeral Home, Lakeland, Florida; Ken Duffy, John E. Day Funeral Home; Red Bank, New Jersey; Barry Ransbottom, Beard Mortuary, Huntington West Virginia; Bill Martinez, Stanfill Funeral Home, Miami, Florida; Courtney Charvet, North Brevard Funeral Home, Titusville, Florida; Mark Cooper, Seaside Funeral Home, Corpus Christi, Texas; Kyle Incardona, Hillier Funeral Home, Bryan-College Station, Texas; Cyndi Hoots, Schmidt Funeral Home, Katy, Texas; Cesar Gutierrez, Heritage-Dilday Memorial Services; Huntington Beach, California; Justin Luyben, Evans-Brown Mortuary & Crematory, Sun City, California.

Now I'll turn the call over to Mel.

Melvin C. Payne - *Carriage Services, Inc. - Founder, Executive Chairman & CEO*

Thank you, Mark. We had a really good quarter, I mentioned in the press release, how good it was compared to some of the history of the company. But I want to mention one thing in particular. This is the first time I think we reduced our Four Quarter Outlook, in a while. And it's been said there were very specific reasons why we did that and I want to really speak to one. The LOI that we have was a really nice business, for reasons that have not gone away but could go away in the future. We mutually decided not to close that, that doesn't mean it won't come back and line up and at some point being another opportunity for us and for them.

We still have a relationship and that relationship will get stronger over time, not broken. But I wanted to mention how proud I am and what Shawn Phillips and his team are doing across the country. He and 3 of his team are really building relationships with first-class owners and the vetting process to even yet past first base and to exchange information and to trust that this is something you might want to be a part of. That's not easy and it takes time, it takes seeding of the relationship, building trust of the relationship, and it takes us using our 10 criteria to that.

Now we've gotten better and better and more efficient, and not wasting time on those businesses that don't fit either culturally or with long-term driving characteristics in our market. And so I wanted to mention, in particular, in this call, because this is an LOI that didn't close and we don't see that often. We have 10 businesses in our pipeline right now. All of them are first-class, they've been vetted, the exchange of information is underway, and that's more serious activity than we've had in my memory. These 10 businesses approximately do about \$35 million revenue. So if you read my shareholder letter, where I go through a deeply analytical review of our funeral portfolio, and the larger businesses and the larger markets. 10 businesses in our pipeline that have an average revenue of \$3.5 million is something I don't remember having before. So how many of those will actually come through the other end of the pipeline, how many of those will be mutually beneficial to have a partnership, or strategic partnership or a good business really gets better in this framework, I don't know. But it won't be zero. And so I don't think anybody should take it as a negative but we had one that didn't close. This is just an exception to the rule. We have a great company, never been more excited about the next 5 or 10 years. I would encourage all of you to read the shareholder letter, '17, '16 to get a feel, getting some really good feedback on the more recent one and the prior one. And we look forward to reporting our performances we go through the year.

I want to just say to all of our people listening on this call, thank you for what you do. None of this would be possible, if not for you. This is your company, your performance, we're just the appointed ones that get lucky enough to report it and talk about it, so thank you very much. All of you. With that I'll turn it over to questions.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Alex Paris from with Barrington Research.

Christopher Huang Howe - *Barrington Research Associates, Inc., Research Division - Research Analyst*

This is Chris Howe sitting in for Alex Paris. First of all in reading the Annual Shareholder Letter, just wanted to say congrats on achieving your Roughly Right Range of outcomes, highlighted on page 19, that's quite the achievement.

And my first question was just kind of a bookkeeping question, any LOIs in the Rolling Four Quarter guidance that you've provided? And my next question, Mel answered a lot of my questions very well in regard to the LOI that was unsigned and in regard to the pipeline mix with the 10 businesses, and -- but in regard to that pipeline mix, can you maybe give a general overview on how it compares to where the pipeline was versus maybe a year or 2 ago? And in reference to the Annual Shareholder Letter, how it relates to the corridor that you highlighted? And in addition the 10-year plan of the 5 to 10 potential new markets?

Melvin C. Payne - *Carriage Services, Inc. - Founder, Executive Chairman & CEO*

Yes, that's a great question. And thank you for the depth in the linking of the question that we wrote about in the Shareholder Letter. This pipeline today compares to -- let's say 2 years ago. I would say the pipeline 2 years ago was a joke. This is not a joke. This is serious, this is good. Two years ago it was a joke but the jokers are no longer here. We've got the players on the field and I blame myself for that, what I didn't realize is that this idea, this concept of our framework with high-performance standards that relate to the top operators in the industry. They relate to these ideas as opposed to a budget model and the people that I have previously had doing Corporate Development. Never figured out what the company was about, they knew financial part, they knew a lot of that, but unless you can relate at the operational level because the standards really are 8 in the funeral side, 8 performance standards that don't change, they're like guiding principles and these are not easy to achieve. And I wrote in the Shareholder Letter, you know if you can do 70% to 85%, consistently over many years, that's really high performance, that's kind of generate financial performance, this is just like -- oh this is too good to be true, but it is true. We're going to Washington -- I'm going to Washington today after this call, we're taking how many, people we've taken to Washington?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, Senior VP & Treasurer*

35.

Melvin C. Payne - *Carriage Services, Inc. - Founder, Executive Chairman & CEO*

35 winners, Pinnacle winners and these are high standards achievement winners across our portfolio and their spouses, and we treat them like kings and queens, because what they do is hard and the people we're talking to now those 10 businesses, I mean I'm getting e-mails passed on to me just for having dinners with them. When they say, " We never realized. There was a company like Carriage. We never realized, that we could hook up with a company like Carriage and get better and not be over managed in the short term it get worse". This is just 2 days ago, I'm getting these e-mails. So these are top-quality businesses. And we're finding these niche markets in some of the cities I mentioned in my shareholder letter. Some -- already we have a small presence and we want more, let's say Chicago, Virginia, North Carolina, South Carolina, California. Yes, I can go on and on and on and there are others. And we're talking to them, we know who they are, we're finding new ones, we didn't know who they were, and we're shocked at what they're doing, their ideas, their growth, the demographics, and their package. You have to look for this, they are just not everywhere. And so I am more excited about what is in this pipeline and what's coming. And this is going to be consistent before it was hit and miss and it was a joke. It was a joke, and I finally said, " I'm tired of the joke. Let's start over". And that took a while, we're there, and it's good.

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Carl Benjamin Brink - *Carriage Services, Inc. - CFO, Senior VP & Treasurer*

And Chris to your bookkeeping question, there are no LOIs that are included in this Rolling Four Quarter Outlook.

Christopher Huang Howe - *Barrington Research Associates, Inc., Research Division - Research Analyst*

Okay. Thank you so much for the color, Mel, that was very helpful and definitely look forward to what's on the horizon for Carriage. And Ben, I had one question for you just kind of what are your budgeting internally as much as you can share in regards to cash flow, and more specifically, depreciation and amortization, maintenance CapEx and CapEx moving forward?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, Senior VP & Treasurer*

Yes, I would say. So for the balance of the year, I think it's safe to assume free cash flow will look a lot like we were the last 2 quarters of last year, probably a little higher, we had a really strong first quarter so we're off to a really good start, so you can add that on there. In terms of CapEx, I would say be -- it's going to be really consistent with where we were last year, we don't see any more large spikes or decreases in CapEx and our maintenance CapEx tends to be pretty steady. And a good way to think about it is maintenance CapEx is anywhere between 3.5% and 4% of funeral and cemetery operating revenue.

And G&A, I think what you saw on the first quarter will be consistent throughout the year, it's a little higher year-over-year due to the acquisitions we made at the end of last year, along with an increase in cemetery property sales, which we saw in the first quarter, up 8% same-store cemetery sales or cemetery revenue. So if you have any other specifics feel free to give me a shout offline.

Operator

And our next question comes from the line of Chris McGinnis with Sidoti.

Christopher Paul McGinnis - *Sidoti & Company, LLC - Special Situations Equity Analyst*

Great letter, additionally, I think just the level of insight especially around the same-store portfolio, that was really interesting. So thanks for putting that out and just on the question and Mel follow up kind of from the last question -- not the last question but just in regards to the pipeline and what's the biggest change between the personnel? And how are they driving or a little bit more effective than the prior team that was around the M&A? And can you just maybe provide a little bit insight on that?

Melvin C. Payne - *Carriage Services, Inc. - Founder, Executive Chairman & CEO*

That's a very good question. I mean the people who are here in the past had good intentions, that wasn't the question. But they didn't understand the Standards Operating Model, number one. They never understood a strategic way of thinking about businesses and markets and the characteristics that drive long-term performance. And I've written extensively about the model, the economic drivers volumes, how do you get volumes, you put an entrepreneur in charge of a business locally and let he or she figure it out, you can't figure it out, like a Pentagon, they never understood that. There was always centralized top-down initiatives. And that's what they knew and that's where they came from, it wasn't a fit. So they didn't understand the business and the operations of the business.

And then they put people in with them who also didn't understand, there were more financial people, budget people, or whatever but they didn't understand it either. So what we have now, Shawn Phillips is a Funeral guy, and he ran an individual funeral home, he later had long careers with SCI, Alderwoods, and then he joined us September of '07 to head the West. So this was an operating guy. He headed the West and then he later get transferred to the central and it was original partner. So he was responsible for finding managing partners in charge of these businesses and these -- to achieve high standards. So he understood the business and he understood the concepts and methodologies and the idea of our Standards



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Operating Model, which is -- I wrote a lot about this stuff, it's hard for people to get their heads around. It produces powerful results in this industry because it's a customized high-performance language around the drivers, the economic drivers and Shawn understood [standards]. So finally, I'm going, "Shawn, you need to take this job." He said, "I've never done that." I said, "Good, that means you don't know anything about how it should be done, but you know the model and you know the business." That's been the difference. Now he is brought in people under him, one guy was a managing partner one of our tops. He is actually run a business under these standards, so he can explain it to these people, so you got real operating people, not financial people, out doing acquisition work. And it's made all the difference in the world because they were late at the very personal and business level, the nature of the business. And they can explain how the business what's it becomes part of Carriage, is not over managed, lot of horror stories, it's supported and we're finding younger and younger owners wanting to join because they've got ideas of how to grow the business with new chapels, the new growth corridors. And we provide a strategic partnership for them to really grow and then we share depth side with them. What a normal idea and we don't have layers eaten up their performance.

So it's really unique and most of these really top owners, you sit down with them initially they find it too good to be true. But then they do a round, a checking, they read, they get references from former owners, MPs, and then -- if they come here that's where the rubber meets the road, if they come here or go see some of our people, then we're going to do something, that's the difference. These people are doing this work now relate and know all of our other people in the field. But people doing it before didn't relate and didn't know all the people in the field nor the business.

Christopher Paul McGinnis - *Sidoti & Company, LLC - Special Situations Equity Analyst*

Makes sense. I guess just 2 follow-ups and a little bit, I know shorter term but just if you don't mind me asking. Just around the improvement around the cemetery side, is that due to the new people in place? And can you maybe just talk a little bit about the trends there? And then second I have a question on the trust for the remainder of the year.

Mark R. Bruce - *Carriage Services, Inc. - COO & Senior VP*

Yes, this is Mark. On the cemetery, yes, it was -- it's the first two than what, it's going out and flying high-quality talented managing partners and then supporting them, and the addition of Kevin Doherty, who joined our team in May of last year, who came with 30 years of sales experience, operating experience, in addition to the other support provided by our team here has made world of difference and we have much more work to do but we are -- we continue to be encouraged by the performance in the most recent period.

Christopher Paul McGinnis - *Sidoti & Company, LLC - Special Situations Equity Analyst*

Great, great. Yes, nice work there. And then just lastly maybe Ben, if you could just talk a little bit about your thoughts about the trust for the remainder of the year and the impact on earnings?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, Senior VP & Treasurer*

Yes, I think we talked about for the -- trust performance is not quite -- is not apples to apples or one-for-one with our financial revenue performance. I would expect financial revenue and EBITDA again to be very consistent from where we are -- where we were last year, I don't see any large spikes or large changes. Certainly our performance in the short term in the trust was a little bit below our benchmark in the quarter for very specific reasons and we know what those are. We feel good about the trust positioning where we are now, we have a lot of flexibility in the portfolio and probably holding more cash, which we've done over the last 18 months then we would like to we normally do, just waiting for good opportunities to come our way. We certainly shifted some of the portfolio away from high-yield fixed income towards either cash or equities, and that's just a relative value where we see the market is today and we expect to continue to manage it as we have over the past 9-plus years.



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Melvin C. Payne - *Carriage Services, Inc. - Founder, Executive Chairman & CEO*

On the trust, we've been ready, we've been waiting for major -- major decline whether that happened or not. But we got ready for that. All of that, Ben?

Carl Benjamin Brink - *Carriage Services, Inc. - CFO, Senior VP & Treasurer*

Yes.

Melvin C. Payne - *Carriage Services, Inc. - Founder, Executive Chairman & CEO*

And you know when it dips way down and it's real scary on some days, we buy a little bit of this or that that we've been looking at. We still get drop [out there] .

Operator

And at this time I am showing no further questions. I would like to turn the call back over to Mel Payne for any closing remarks.

Melvin C. Payne - *Carriage Services, Inc. - Founder, Executive Chairman & CEO*

I don't really have anything to add, I think it's been a short call and good quarter. Let's keep it going. Thank you very much.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. And you may all disconnect. Everyone, have a great day.

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