CARRIAGE SERVICES INC
Form 10-Q
May 09, 2008

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

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2008

OR

o **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	**76-0423828**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3040 Post Oak Boulevard, Suite 300, Houston, TX	**77056**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (713) 332-8400

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 þ No o

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 in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of the registrant s Common Stock, $.01 par value per share, outstanding as of May 1, 2008 was 19,438,811.

CARRIAGE SERVICES, INC.
INDEX

Table of Contents

PART I FINANCIAL INFORMATION
Item 1. Financial Statements

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

	December 31, 2007	March 31, 2008 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,446	$ 4,843
Accounts receivable, net of allowance for doubtful accounts of $1,142 in 2007 and $1,105 in 2008	16,421	15,123
Inventories and other current assets	13,686	13,136
Total current assets	33,553	33,102
Preneed cemetery trust investments	61,114	60,107
Preneed funeral trust investments	68,292	70,604
Preneed receivables, net of allowance for cancellations and doubtful accounts of $1,159 in 2007 and $948 in 2008	18,333	14,237
Receivables from preneed funeral trusts	15,012	14,681
Property, plant and equipment, at cost, net of accumulated depreciation of $53,304 in 2007 and $55,218 in 2008	125,608	124,901
Cemetery property	68,028	68,175
Goodwill	167,263	167,265
Deferred charges and other non-current assets	16,402	15,152
Cemetery perpetual care trust investments	37,202	35,794
Total assets	$ 610,807	$ 604,018
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of senior long-term debt and capital leases obligations	$ 1,256	$ 983
Accounts payable	6,091	6,228
Accrued liabilities	14,559	8,638
Total current liabilities	21,906	15,849
Senior long-term debt, net of current portion	132,994	132,824
Convertible junior subordinated debenture due in 2029 to an affiliated trust	93,750	93,750
Obligations under capital leases, net of current portion	4,663	4,647
Deferred preneed cemetery revenue	50,610	52,592
Deferred preneed funeral revenue	34,277	27,313
Non-controlling interests in cemetery trust investments	61,114	60,107

Non-controlling interests in funeral trust investments		68,292		70,604
Total liabilities		467,606		457,686
Commitments and contingencies				
Non-controlling interests in perpetual care trust investments		36,301		35,590
Stockholders equity:				
Common Stock, $.01 par value; 80,000,000 shares authorized; 19,216,000 and 19,412,000 shares issued and outstanding at December 31, 2007 and March 31, 2008, respectively		192		194
Additional paid-in capital		193,006		193,557
Accumulated deficit		(86,298)		(83,009)
Total stockholders equity		106,900		110,742
Total liabilities and stockholders equity	$	610,807	$	604,018

The accompanying condensed notes are an integral part of these consolidated financial statements.

Table of Contents

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

	For the three months ended March 31, 2007	2008
Revenues:		
Funeral	$ 32,378	$ 37,251
Cemetery	10,087	9,901
	42,465	47,152
Field costs and expenses:		
Funeral	19,343	21,868
Cemetery	6,299	7,068
Depreciation and amortization	2,115	2,127
Regional and unallocated funeral and cemetery costs	1,819	2,065
	29,576	33,128
Gross profit	12,889	14,024
Corporate costs and expenses:		
General, administrative and other	3,485	3,650
Home office depreciation and amortization	364	409
	3,849	4,059
Interest and other:		
Interest expense	(4,620)	(4,619)
Interest income and other, net	445	90
	(4,175)	(4,529)
Income from continuing operations before income taxes	4,865	5,436
Provision for income taxes	(1,873)	(2,147)
Net income from continuing operations	2,992	3,289
Income from discontinued operations, net of tax	430	
Net income	$ 3,422	$ 3,289
Basic earnings per common share:		
Continuing operations	$ 0.16	$ 0.17
Discontinued operations	0.02	

Net income	$ 0.18	$ 0.17
Diluted earnings per common share:		
Continuing operations	$ 0.16	$ 0.17
Discontinued operations	0.02	
Net income	$ 0.18	$ 0.17
Weighted average number of common and common equivalent shares outstanding:		
Basic	18,763	19,344
Diluted	19,285	19,770

The accompanying condensed notes are an integral part of these consolidated financial statements.

Table of Contents

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

	For the three months ended March 31, 2007	2008
Cash flows from operating activities:		
Net income	$ 3,422	$ 3,289
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from discontinued operations	(430)	
Depreciation and amortization	2,480	2,530
Amortization of deferred financing costs	179	179
Provision for losses on accounts receivable	662	1,024
Stock-based compensation expense	251	347
Deferred income taxes	1,873	2,107
Other	(109)	(22)
Changes in operating assets and liabilities that provided (required) cash, net of effects from acquisitions and dispositions:		
Accounts receivable	(889)	338
Inventories and other current assets	(175)	(593)
Deferred charges and other	22	60
Preneed funeral and cemetery trust investments	(2,041)	4,529
Accounts payable and accrued liabilities	(5,696)	(5,991)
Deferred preneed funeral and cemetery revenue	(400)	(4,982)
Non-controlling interests in preneed funeral and cemetery trusts	2,752	594
Net cash provided by operating activities of discontinued operations	47	
Net cash provided by operating activities	1,948	3,409
Cash flows from investing activities:		
Acquisitions	(9,992)	
Maturities of corporate investments	10,303	
Capital expenditures	(2,169)	(1,759)
Net cash provided by investing activities of discontinued operations	2,420	
Net cash provided by (used in) investing activities	562	(1,759)
Cash flows from financing activities:		
Payments on senior long-term debt and obligations under capital leases	(394)	(459)
Proceeds from the exercise of stock options and employee stock purchase plan	323	165
Tax benefit from stock-based compensation	172	41
Net cash provided by (used in) financing activities	101	(253)
Net increase in cash and cash equivalents	2,611	1,397
Cash and cash equivalents at beginning of period	22,820	3,446

Cash and cash equivalents at end of period	$ 25,431	$ 4,843

The accompanying condensed notes are an integral part of these consolidated financial statements.

Table of Contents

CARRIAGE SERVICES, INC.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) The Company

Carriage Services, Inc. (Carriage or the Company) is a leading provider of death care services and merchandise in the United States. As of March 31, 2008, the Company owned and operated 139 funeral homes in 25 states and 32 cemeteries in 11 states.

(b) Principles of Consolidation

The accompanying consolidated financial statements include the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated.

(c) Interim Condensed Disclosures

The information for the three month periods ended March 31, 2007 and 2008 is unaudited, but in the opinion of management, reflects all adjustments which are normal, recurring and necessary for a fair presentation of financial position and results of operations as of and for the interim periods presented. Certain information and footnote disclosures, normally included in annual financial statements, have been condensed or omitted. The accompanying consolidated financial statements have been prepared consistent with the accounting policies described in our annual report on Form 10-K for the year ended December 31, 2007, and should be read in conjunction therewith.

(d) Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

(e) Use of Estimates

The preparation of the consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, we evaluate estimates and judgments, including those related to revenue recognition, realization of accounts receivable, intangible assets, property and equipment and deferred tax assets. 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 revenues 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 the margins, operating income and net earnings as a percentage of revenues will be consistent from year to year.

(f) Business Combinations

We apply the principles provided in Statement of Financial Accounting Standard (FAS) No. 141R when we acquire businesses. 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 our fair value determination. We customarily estimate our purchase costs and other related transactions known at closing of the acquisition. To the extent that information not available to us at the closing date subsequently becomes available during the allocation period, as defined in FAS No. 141R, we may adjust goodwill, assets, or liabilities associated with the acquisition.

(g) Discontinued Operations

In accordance with the Company s strategic portfolio optimization model, non-strategic businesses are reviewed to determine whether the business should be sold and proceeds redeployed elsewhere. A marketing plan is then developed for those locations which are identified as held for sale. When the Company receives a letter of intent and financing commitment from the buyer and the sale is expected to occur within one year, the location is no longer reported within the Company s continuing operations. The assets and liabilities associated with the location are reclassified as held for sale on the balance sheet and the operating results, as well as impairments, are presented on a comparative basis in the discontinued operations section of the consolidated statements of operations, along with the income tax effect.

Table of Contents

(h) Stock Plans and Stock-Based Compensation

The Company has stock-based employee compensation plans in the form of restricted stock, performance units, stock option and employee stock purchase plans, which are described in more detail in Note 18 to the consolidated financial statements in our Form 10-K for the year ended December 31, 2007. The Company accounts for stock-based compensation under SFAS No. 123R, Share-Based Payment (FAS No. 123R). The Company adopted FAS No. 123R in the first quarter of 2006, using the modified prospective application method. FAS No. 123R requires companies to recognize compensation expense in an amount equal to the fair value of the share-based awards issued to employees over the period of vesting and applies to all transactions involving issuance of equity by a company in exchange for goods and services, including employee services. The fair value of options or awards containing options is determined using the Black-Scholes valuation model.

2. RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, Fair Value Measurements (FAS No. 157). Statement No. 157 defines fair value, establishes a framework for measuring fair value under Generally Accepted Accounting Principles (GAAP) and expands disclosures about fair value measures, but does not require any new fair value measurements. FAS No. 157 is effective for fiscal years beginning after November 15, 2007. The provisions of FAS No. 157 are to be applied on a prospective basis, with the exception of certain financial instruments for which retrospective application is required. FASB Staff Position No. FAS 157-2 (FSP 157-2), issued in February 2008, delayed the effective date of FAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until fiscal years beginning after November 15,2 008. We adopted FAS No. 157 effective January 1, 2008, with the exceptions allowed under FSP 157-2, the adoption of which has not affected our financial position or results of operations but did result in additional required disclosures, which are provided in Note 16.

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (FAS No. 159). FAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. FAS No. 159 is effective for fiscal years beginning after November 15, 2007. We have not elected to apply the provisions of Statement No. 159 to any of our financial instruments as of March 31, 2008; therefore, the adoption of Statement No. 159 effective January 1, 2008 has not affected our financial position or results of operations.

In December 2007, the FASB issued FAS No. 141(revised 2007), Business Combinations (FAS No. 141R). FAS No. 141R requires the acquiring entity to recognize the assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at the acquisition date, measured at the fair values as of that date. Goodwill is measured as a residual of the fair values at acquisition date. Acquisition related costs are recognized separately from the acquisition. This statement is effective as of the beginning of the first fiscal year that begins after December 15, 2008. The Company is currently evaluating the impact, if any, of the adoption of FAS No. 141R will have on its consolidated financial statements.

In December 2007, the FASB issued Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements , an amendment of ARB No. 51 (FAS No. 160). FAS No. 160 requires that non-controlling interests in a subsidiary be reported as equity in the consolidated financial statements, the attributable net income be identified and presented on the face of the consolidated statement of income and changes in the ownership be accounted for consistently. The statement also includes requirements when an interest is deconsolidated. Disclosure should be sufficient to clearly identify and distinguish between the interests of the reporting entity and that of the non-controlling interest owners. This statement is effective as of the beginning of the first fiscal year that begins after December 15, 2008. The Company is currently evaluating the impact, if any, of the adoption of FAS No. 160 will have on its consolidated financial statements.

3. CHANGE IN ACCOUNTING FOR INCOME TAX UNCERTAINTIES

In June 2006, FASB issued FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes how tax benefits for uncertain tax positions are to be recognized, measured, and derecognized in financial statements; requires certain disclosures of uncertain tax matters; specifies how reserves for uncertain tax position should be classified on the balance sheet; and provides transition and interim period guidance, among other provisions. FIN 48 is effective for fiscal years beginning after December 15, 2006 and was adopted by the Company at the beginning of the first quarter of 2007. The Company has reviewed its income tax positions and identified certain tax deductions, primarily related to business acquisitions that are not certain. The cumulative effect of adopting FIN 48 has been recorded as a reduction to the 2007 opening balance of Retained Earnings and an increase in noncurrent liabilities in the amount of $0.2 million to the January 1, 2007 retained earnings balance.

The Company has unrecognized tax benefits for Federal and state income tax purposes totaling $6.0 million as of December 31, 2007, resulting from deductions totaling $15.2 million on Federal returns and $13.4 million on various state returns. The effect of applying FIN 48 for the quarter ended March 31, 2008 was not material to the Company s operations. The Company has federal and state net operating loss carryforwards exceeding these deductions, and has accounted for these unrecognized tax benefits by reducing the net operating loss carryforwards by the amount of these unrecognized deductions. In certain states

Table of Contents

without net operating loss carryforwards, the Company has previously reduced its taxes payable by deductions that are not considered more likely than not. The cumulative effect of adopting FIN 48 specifically relates to those state income tax returns.

The entire balance of unrecognized tax benefits, if recognized, would affect the Company s effective tax rate. The Company does not anticipate a significant increase or decrease in its unrecognized tax benefits during the next twelve months. The amount of penalty and interest recognized in the balance sheet and statement of operations was not material. The Company s policy with respect to potential penalties and interest is to record them as other expense and interest expense, respectively.

4. DISCONTINUED OPERATIONS

The Company continually reviews locations to optimize the sustainable earning power and return on invested capital of the Company. The Company s strategy, the Strategic Portfolio Optimization Model, uses strategic ranking criteria to identify disposition candidates. The execution of this strategy entails selling non-strategic businesses.

No businesses were sold during the three months ending March 31, 2008.

In the first quarter of 2007, the Company sold two funeral home businesses for approximately $2.4 million and recognized a gain of $0.7 million. During 2006, the Company recorded impairment charges totaling $6.1 million, which is related to specifically identified goodwill, for these businesses.

No businesses were held for sale at December 31, 2007 and March 31, 2008.

The operating results of businesses discontinued during the periods presented, as well as impairments and gains or losses on the disposal, are presented on a comparative basis in the discontinued operations section of the consolidated statements of operations, along with the income tax effect. Likewise, the operating results, impairment charges and gains or losses from businesses sold in the prior year have been similarly reported for comparability. Revenues and operating income for the businesses presented in the discontinued operations section are as follows (in thousands):

	For the three months ended March 31,	
	2007	2008
Revenues	$ 327	$
Operating income	$ 20	$
Gain on sale	677	
Provision for income taxes	(267)	
Income from discontinued operations	$ 430	$

5. PRENEED TRUST INVESTMENTS

Preneed cemetery trust investments

Preneed cemetery trust investments represent trust fund assets that the Company will withdraw when the merchandise or services are provided. The cost and market values associated with preneed cemetery trust investments at March 31, 2008 are detailed below (in thousands). The Company believes the unrealized losses related to trust investments are temporary in nature.

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash and money market accounts	$ 6,205	$	$	$ 6,205
Fixed income securities:				
U.S. and Agency obligations	17,846	722		18,568
State and municipal obligations	351	12		363

Corporate	1,949	50	(8)	1,991
Other	5			5
Common stock	13,010	906	(1,412)	12,504
Mutual funds:				
Equity	14,179	622	(465)	14,336
Fixed income	5,866	294	(306)	5,854
Trust investments	$ 59,411	$ 2,606	$ (2,191)	$ 59,826
Accrued investment income	$ 281			$ 281
Trust assets				$ 60,107
Market value as a percentage of cost				100.7%

Table of Contents

The estimated maturities of the fixed income securities included above are as follows (in thousands):

	Cost	Net Unrealized Gain	Market
Due in one year or less	$ 1,575	$ 14	$ 1,589
Due in one to five years	14,118	592	14,710
Due in five to ten years	4,453	170	4,623
Thereafter	5		5
	$ 20,151	$ 776	$ 20,927

Preneed funeral trust investments

Preneed funeral trust investments represent trust fund assets that the Company expects to withdraw when the services and merchandise are provided. Such contracts are secured by funds paid by the customer to the Company. Preneed funeral receivables and trust investments are reduced by the trust investment earnings the Company has been allowed to withdraw prior to performance by the Company and amounts received from customers that are not required to be deposited into trust, pursuant to various state laws.

The cost and market values associated with preneed funeral trust investments at March 31, 2008 are detailed below (in thousands). The Company believes the unrealized losses related to trust investments are temporary in nature.

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash and money market accounts	$ 36,780	$	$	$ 36,780
Fixed income securities:				
U.S. Treasury	7,055	377		7,432
State and municipal obligations	1,513	53		1,566
Corporate	1,689	52		1,741
Mortgage Backed Securities	1,569	62		1,631
Common stock	4,178	584	(413)	4,349
Mutual funds:				
Equity	12,317	802	(721)	12,398
Fixed income	4,693	124	(110)	4,707
Trust investments	$ 69,794	$ 2,054	$ (1,244)	$ 70,604
Market value as a percentage of cost				101.2%

The estimated maturities of the fixed income securities included above are as follows (in thousands):

Net