CARRIAGE SERVICES INC
Form 10-Q
May 07, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014
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, Texas, 77056
(Address of principal executive offices)
(713) 332-8400
(Registrant’s telephone number, including area code)

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 x No o

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 x 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 Securities Exchange Act of 1934.

Large accelerated filer	o	Accelerated filer	x
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 x

The number of shares of the registrant’s Common Stock, $.01 par value per share, outstanding as of May 5, 2014 was 18,480,253.

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements
CARRIAGE SERVICES, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	December 31, 2013	(unaudited) March 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$1,377	$21,958
Accounts receivable, net of allowance for bad debts of $847 in 2013 and $917 in 2014	17,950	17,715
Assets held for sale	3,544	—
Inventories	5,300	5,348
Prepaid expenses	4,421	4,387
Other current assets	3,525	1,754
Total current assets	36,117	51,162
Preneed cemetery trust investments	68,341	69,475
Preneed funeral trust investments	97,144	100,204
Preneed receivables, net of allowance for bad debts of $1,825 in 2013 and $1,887 in 2014	24,521	24,282
Receivables from preneed trusts	11,166	11,738
Property, plant and equipment, net of accumulated depreciation of $88,627 in 2013 and $90,250 in 2014	160,690	161,829
Cemetery property	72,911	72,852
Goodwill	221,087	220,945
Deferred charges and other non-current assets	12,280	13,416
Cemetery perpetual care trust investments	42,342	43,529
Total assets	$746,599	$769,432
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Current portion of senior long-term debt and capital lease obligations	$13,424	$14,078
Accounts payable	7,046	5,231
Other liabilities	9,939	9,350
Accrued liabilities	12,854	12,558
Liabilities associated with assets held for sale	4,357	—
Total current liabilities	47,620	41,217
Long-term debt, net of current portion	105,642	101,783
Revolving credit facility	36,900	—
Convertible junior subordinated debentures due in 2029 to an affiliate	89,770	27,860
Convertible subordinated notes due 2021	—	112,261
Obligations under capital leases, net of current portion	3,786	1,343
Deferred preneed cemetery revenue	55,479	55,019
Deferred preneed funeral revenue	30,588	31,102
Deferred tax liability	11,915	18,290
Other long-term liabilities	1,548	1,612
Deferred preneed cemetery receipts held in trust	68,341	69,475
Deferred preneed funeral receipts held in trust	97,144	100,204

Care trusts' corpus	41,893	43,566
Total liabilities	590,626	603,732
Commitments and contingencies:		
Stockholders' equity:		
Common stock, $.01 par value; 80,000,000 shares authorized; 22,183,000 and 22,408,000 shares issued at December 31, 2013 and March 31, 2014, respectively	222	224
Additional paid-in capital	204,324	211,831
Accumulated deficit	(33,306)	(31,088)
Treasury stock, at cost; 3,922,000 shares at December 31, 2013 and March 31, 2014	(15,267)	(15,267)
Total stockholders' equity	155,973	165,700
Total liabilities and stockholders' equity	$746,599	$769,432

The accompanying condensed notes are an integral part of these Consolidated Financial Statements.

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

	For the Three Months Ended March 31,	
	2013	2014
Revenues:		
Funeral	$45,051	$44,159
Cemetery	12,264	11,688
	57,315	55,847
Field costs and expenses:		
Funeral	26,352	26,039
Cemetery	6,815	6,960
Depreciation and amortization	2,476	2,422
Regional and unallocated funeral and cemetery costs	2,759	2,379
	38,402	37,800
Gross profit	18,913	18,047
Corporate costs and expenses:		
General and administrative costs and expenses	6,282	9,335
Home office depreciation and amortization	347	342
	6,629	9,677
Operating income	12,284	8,370
Interest expense	(2,595)	(2,845)
Accretion of discount on convertible subordinated notes	—	(171)
Loss on redemption of convertible junior subordinated debentures	—	(3,778)
Other income	—	1,130
Income from continuing operations before income taxes	9,689	2,706
Provision for income taxes	(4,280)	(1,055)
Net income from continuing operations	5,409	1,651
Income (loss) from discontinued operations, net of tax	(151)	567
Net income	5,258	2,218
Preferred stock dividend	(4)	—
Net income available to common stockholders	$5,254	$2,218
Basic earnings (loss) per common share:		
Continuing operations	$0.30	$0.09
Discontinued operations	(0.01)	0.03
Basic earnings per common share	$0.29	$0.12
Diluted earnings (loss) per common share:		
Continuing operations	$0.26	$0.09
Discontinued operations	(0.01)	0.03
Diluted earnings per common share	$0.25	$0.12
Dividends declared per common share	$0.025	$0.025
Weighted average number of common and common equivalent shares outstanding:		
Basic	17,657	17,984
Diluted	22,246	18,143

The accompanying condensed notes are an integral part of these Consolidated Financial Statements.

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

	For the Three Months Ended March 31, 2013	2014
Cash flows from operating activities:		
Net income	$5,258	$2,218
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Loss (gain) on sale / purchase of businesses and other assets	389	(2,039)
Impairment of goodwill	100	—
Depreciation and amortization	2,848	2,764
Amortization of deferred financing costs	(638)	232
Accretion of debt discount on convertible subordinated notes	—	171
Provision for losses on accounts receivable	456	700
Stock-based compensation expense	646	1,491
Deferred income taxes	1,354	(4,780)
Loss on redemption of convertible junior subordinated debentures	—	2,932
Other	(34)	(3)
Changes in operating assets and liabilities that provided (required) cash:		
Accounts and preneed receivables	(1,904)	(245)
Inventories and other current assets	478	299
Deferred charges and other	21	(318)
Preneed funeral and cemetery trust investments	1,410	(5,258)
Accounts payable	(874)	(2,566)
Accrued and other liabilities	(280)	(2,387)
Deferred preneed funeral and cemetery revenue	2,617	(37)
Deferred preneed funeral and cemetery receipts held in trust	(1,934)	5,208
Net cash provided by (used in) operating activities	9,913	(1,618)
Cash flows from investing activities:		
Acquisitions and new construction	(6,051)	—
Net proceeds from the sale of businesses and other assets	2,011	200
Capital expenditures	(2,602)	(5,048)
Net cash used in investing activities	(6,642)	(4,848)
Cash flows from financing activities:		
Net payments on the revolving credit facility	(1,700)	(36,900)
Payments on term loan	(2,500)	(3,000)
Proceeds from the issuance of convertible subordinated notes	—	143,750
Payment of debt issuance costs related to the convertible subordinated notes	—	(4,355)
Payments on other long-term debt and obligations under capital leases	(168)	(185)
Redemption of convertible junior subordinated debentures	—	(61,905)
Payments for performance-based stock awards	—	(16,150)
Proceeds from the exercise of stock options and employee stock purchase plan contributions	318	652
Dividends on common stock	(452)	(456)
Dividend on redeemable preferred stock	(4)	—
Payment of loan origination costs	(98)	—

Excess tax benefit of equity compensation	925	5,596
Net cash provided by (used in) financing activities	(3,679)	27,047
Net increase (decrease) in cash and cash equivalents	(408)	20,581
Cash and cash equivalents at beginning of period	1,698	1,377
Cash and cash equivalents at end of period	$1,290	$21,958

The accompanying condensed notes are an integral part of these Consolidated Financial Statements.

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

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 deathcare services and merchandise in the United States. As of March 31, 2014, we operated 161 funeral homes in 26 states and 31 cemeteries in 10 states.

Our operations are reported in two business segments: Funeral Home Operations and Cemetery Operations. Funeral homes are principally service businesses that provide funeral services (traditional burial and cremation) and sell related merchandise, such as caskets and urns. Cemeteries are primarily sales businesses providing interment rights (grave sites and mausoleums) and related merchandise, such as markers and memorials.

Principles of Consolidation

The accompanying Consolidated Financial Statements include us and our subsidiaries. All significant intercompany balances and transactions have been eliminated.

Interim Condensed Disclosures

The information for the three month periods ended March 31, 2013 and 2014 is unaudited, but in the opinion of management, reflects all adjustments which are normal, recurring and necessary for a fair presentation of our 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, 2013 and should be read in conjunction therewith.

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, revenues and expenses. On an ongoing 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 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 that our results of operations will be consistent from year to year.

Funeral and Cemetery Operations

We record the revenue from sales of funeral and cemetery merchandise and services when the merchandise is delivered or the service is performed. Sales of cemetery interment rights are recorded as revenue in accordance with the retail land sales provisions for accounting for sales of real estate. This method provides for the recognition of revenue in the period in which the customer's cumulative payments exceed 10% of the contract price related to the interment right. Costs related to the sales of interment rights, which include real property and other costs related to cemetery development activities, are charged to operations using the specific identification method in the period in which the sale of the interment right is recognized as revenue. Revenues to be recognized from the delivery of merchandise and performance of services related to contracts that were acquired in acquisitions are typically lower than those originated by the Company. Sales taxes collected are recognized on a net basis in our Consolidated Financial Statements.

Allowances for bad debts and customer cancellations are provided at the date that the sale is recognized as revenue and are based on our historical experience and the current economic environment. We also monitor changes in delinquency rates

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and provide additional bad debt and cancellation reserves when warranted. When preneed sales of funeral services and merchandise are funded through third-party insurance policies, we earn a commission on the sale of the policies. Insurance commissions are recognized as revenues at the point at which the commission is no longer subject to refund, which is typically one year after the policy is issued.

Accounts receivable included approximately $8.4 million of funeral receivables at December 31, 2013 and March 31, 2014 and $8.3 million and $9.1 million of cemetery receivables at December 31, 2013 and March 31, 2014, respectively. Non-current preneed receivables represent the payments expected to be received beyond one year from the balance sheet date. Non-current preneed receivables consisted of approximately $8.1 million of funeral receivables at December 31, 2013 and March 31, 2014 and $16.5 million and $16.2 million of cemetery receivables at December 31, 2013 and March 31, 2014, respectively. Accounts receivable also include minor amounts of other receivables. Bad debt expense totaled $0.5 million and $0.7 million for the three months ended March 31, 2013 and 2014, respectively.

Property, Plant and Equipment

Property, plant and equipment (including equipment under capital leases) are stated at cost. The costs of ordinary maintenance and repairs are charged to operations as incurred, while renewals and betterments are capitalized. Depreciation of property, plant and equipment (including equipment under capital leases) is computed based on the straight-line method.

Property, plant and equipment was comprised of the following at December 31, 2013 and March 31, 2014:

	December 31, 2013	March 31, 2014
	(in thousands)	
Land	$55,639	$56,890
Buildings and improvements	132,172	133,196
Furniture, equipment and automobiles	61,506	61,993
Property, plant and equipment, at cost	249,317	252,079
Less: accumulated depreciation	(88,627)	(90,250)
Property, plant and equipment, net	$160,690	$161,829

During the three months ended March 31, 2014, we purchased two buildings which we had previously leased. We recognized a gain of approximately $1.1 million on the purchase of one of these buildings that we had originally acquired under a capital lease. We recorded approximately $2.2 million of depreciation expense against operating income for the three months ended March 31, 2013 and 2014.

Discontinued Operations

In accordance with our Strategic Acquisition Model, non-strategic businesses are reviewed to determine whether such businesses should be sold and the proceeds redeployed elsewhere. When we receive a letter of intent and financing commitment from a buyer and the sale is expected to occur within one year, the location is no longer reported within our continuing operations. The assets and liabilities associated with the location are reclassified as held-for-sale on our Consolidated Balance Sheets, and the operating results are presented on a comparative basis in the discontinued operations section of our Consolidated Statements of Operations. During the first quarter of 2014, we sold a cemetery in Florida which was reported as held-for-sale at December 31, 2013. As of March 31, 2014, we had no businesses classified as held-for-sale. See Note 4 and Note 22 to the Consolidated Financial Statements herein for more information.

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 customarily estimate related transaction costs known at closing. To the extent that information not available to us at the closing date of an acquisition subsequently becomes available during the allocation period, we may adjust goodwill, assets or liabilities associated with such acquisition. Acquisition related costs are recognized separately from acquisitions and are expensed as incurred. There were no acquisitions of businesses in the first quarter of 2014. See Note 3 to the Consolidated Financial Statements herein for more information.

Goodwill

The excess of the purchase price over the fair value of identifiable net assets of funeral home businesses acquired is recorded as goodwill. Goodwill has primarily been recorded in connection with the acquisition of funeral businesses. Goodwill is tested for impairment by assessing the fair value of each of our reporting units. The funeral segment reporting units consist of

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our East, Central and West regions in the United States, and we perform our annual impairment test of goodwill using information as of August 31 of each year. In addition, we assess the impairment of goodwill 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, significant adverse changes in the business climate which may be indicated by a decline in our market capitalization or decline in operating results.

Our methodology for goodwill impairment testing is described in more detail in Notes 1 and 4 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013 and further discussion of current period activity in Note 5 to the Consolidated Financial Statements herein.

Intangible Assets

Our intangible assets include tradenames primarily resulting from acquisitions. Our tradenames are included in Deferred charges and other non-current assets on our Consolidated Balance Sheets. Our tradenames are considered to have an indefinite life and are not subject to amortization. We test for impairment of intangible assets annually at year end in accordance with the Intangibles Topic of the Accounting Standards Codification (“ASC”) 350.

In addition to our annual review, we assess the impairment of intangible assets whenever events or changes in circumstances indicate that the carrying value 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 results and significant negative industry or economic trends.

Stock Plans and Stock-Based Compensation

We have stock-based employee and director compensation plans under which we may grant restricted stock, stock options, performance awards and stock from our employee stock purchase plan, which are described in more detail in Note 17 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013. We recognize compensation expense in an amount equal to the fair value of the share-based awards expected to vest over the requisite service period. Fair value is determined on the date of the grant. The fair value of options or awards containing options is determined using the Black-Scholes valuation model. The fair value of the performance awards is determined using a Monte-Carlo simulation pricing model. See Note 17 to the Consolidated Financial Statements herein for additional information on 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, convertible junior subordinated debentures and convertible subordinated notes.

Share-based awards that contain nonforfeitable 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 three months ended March 31, 2013, and the corresponding calculation of fully diluted earnings per share, include approximately 4.4 million shares that would be issued upon conversion of our convertible junior subordinated debentures as a result of the application of the if-converted method prescribed by the Financial Accounting Standards Board (“FASB”) ASC 260-10-45. For the three months ended March 31, 2014, shares from the conversion of our convertible junior subordinated debentures and our convertible subordinated notes are excluded from the fully diluted earnings per share calculation because the inclusion of such converted shares would result in an antidilutive impact.

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 (“VIEs”). 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. For these reasons, 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 Sheets. 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/entombment right and certain memorials sold. Income from the trust funds is distributed to us and used to provide 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 a 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.

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"). As of March 31, 2014, CSV RIA provided these services to two institutions, which have custody of 76% 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.

Fair Value Measurements

We define fair value 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 for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). 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. Additional required disclosures are provided in Notes 6, 10 and 11 to the Consolidated Financial Statements 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 three months ended March 31, 2014, 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) the investor has 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 impairment is indicated, then an adjustment is made to reduce the carrying amount to fair value. As of March 31, 2014, no impairments have been identified.

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.

Our convertible junior subordinated debentures, payable to Carriage Services Capital Trust (the "Trust"), pay interest at a fixed rate of 7% and are carried on our Consolidated Balance Sheets at a cost of approximately $27.9 million. The fair value of these securities is estimated to be approximately $28.0 million at March 31, 2014, based on Bloomberg Finance L.P.'s quotes for the corresponding preferred securities issued by the Trust. Our convertible subordinated notes due 2021, issued in March 2014, pay interest at a fixed rate of 2.75% and are carried on our Consolidated Balance Sheet at a carrying value of approximately $112.3 million. The fair value of these securities is estimated to be approximately $151.7 million based on the last traded or broker quoted price.

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Income Taxes

We and our subsidiaries file a consolidated U.S. Federal income tax return, separate income tax returns in 16 states in which we operate and combined or unitary income tax returns in 11 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 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 financial statements; provide certain disclosures of uncertain tax matters; and specify how reserves for uncertain tax positions should be classified on our Consolidated Balance Sheets. We have reviewed our income tax positions and identified certain tax deductions, primarily related to business acquisitions that are not certain. Our policy with respect to potential penalties and interest is to record them as “Other” expense and “Interest” expense, respectively. The entire balance of unrecognized tax benefits, if recognized, would affect our effective tax rate.

We do not anticipate a significant increase or decrease in unrecognized tax benefits during the next twelve months.

In September 2013, the U.S. Department of the Treasury and the Internal Revenue Service released final regulations relating to guidance on applying tax rules to amounts paid to acquire, produce or improve tangible personal property as well as rules for materials and supplies. The new guidance is required to be applied no later than our tax year beginning January 1, 2014. These regulations are not expected to have a material impact on our financial statements.

Subsequent Events

Management evaluated events and transactions during the period subsequent to March 31, 2014 through the date the financial statements were issued for potential recognition or disclosure in the accompanying financial statements covered by this report. For more information regarding subsequent events, see Note 22 to the Consolidated Financial Statements herein.

2. RECENTLY ISSUED ACCOUNTING STANDARDS

Discontinued Operations and Disclosure of Disposals of Components of an Entity

In April 2014, the FASB modified the requirements for reporting a discontinued operation. The amended definition of “discontinued operations” includes only disposals or held-for-sale classifications for components or groups of components of an entity that represent a strategic shift that either has or will have a major effect on the entity’s operations or financial results. Examples of a strategic shift that has or will have a major effect on an entity’s operations and financial results include a disposal of a major geographical area, line of business, equity method of investment or other parts of an entity. The new definition of discontinued operations will significantly reduce the volume of transactions requiring discontinued operations presentation and disclosure. However, the new guidance also expands the disclosures required when an entity reports a discontinued operation or when it disposes of or classifies as held-for-sale an individually significant component that does not meet the definition of a discontinued operation. The new guidance is effective for all disposals or classifications as held-for-sale that occur in annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity cannot apply the amended guidance to a component or to a business that is classified as held-for-sale before the effective date, even if the component or business is disposed of after the effective date. Early adoption is permitted, but only for disposals or classifications as held-for-sale that have not been reported in previously issued financial statements. We are currently evaluating the impact the adoption of this new guidance will have on our Consolidated Financial Statements.

Income Taxes

In July 2013, the FASB amended the Income Tax Topic of the ASC to eliminate the diversity in practice in the presentation of unrecognized tax benefits. The guidance requires an entity to net its liability for unrecognized tax benefits against the deferred tax assets for all same jurisdiction net operating losses or similar tax loss carryforwards or tax credit carryforwards. A gross presentation will be required only if such carryforwards are not available to settle any additional income taxes resulting from disallowance of the uncertain tax position or the entity does not intend to use these carryforwards for this purpose. This guidance is effective for the first annual or interim period beginning after December 15, 2013, thus effective for us beginning January 1, 2014. Our adoption of this new guidance effective January 1, 2014 did not have a material impact on our financial position or results of operations.

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3. ACQUISITIONS

Our growth strategy includes the execution of our Strategic Acquisition Model. We assess acquisition candidates using six strategic ranking criteria to differentiate the price we are willing to pay under a discounted cash flow methodology. Those criteria are:

- size of business;
- size of market;
- competitive standing;
- local market demographics;
- strength of brand; and
- barriers to entry.

There were no business acquisitions during the first quarter of 2014. We acquired land for approximately $6.0 million during the first quarter of 2013 for funeral home expansion projects.

On March 3, 2014, certain of our subsidiaries entered into an Asset Sale Agreement with certain subsidiaries of Service Corporation International ("SCI") to acquire four funeral businesses and one cemetery business in the New Orleans, Louisiana region and two funeral businesses in the Northern Virginia region for an aggregate purchase price of approximately $54.9 million (the "SCI Acquisition"). Under the Asset Sale Agreement, we will acquire the properties, leasehold interests, assets and rights and assume certain liabilities of the businesses being acquired. The closing of the SCI Acquisition is subject to certain customary closing conditions, including, but not limited to, approval by the Federal Trade Commission. We currently anticipate that the SCI Acquisition will close in the second quarter of 2014.

4. ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

We continually review locations to optimize the sustainable earning power and return on our invested capital. Our strategy, the Strategic Portfolio Optimization Model, also uses strategic ranking criteria to assess potential disposition candidates. The execution of this strategy entails selling generally non-strategic businesses.

During the first quarter of 2014, we sold a cemetery in Florida which was reported as held-for-sale at December 31, 2013 for approximately $0.2 million in cash.

As of March 31, 2014, we had no assets classified as held-for-sale. Assets and liabilities associated with the businesses held-for-sale on our Consolidated Balance Sheets at December 31, 2013 consisted of the following (in thousands):

	December 31, 2013
Assets:	
Current assets	$30
Preneed cemetery trust investments	2,477
Preneed receivables	31
Property, plant and equipment, net	311
Cemetery perpetual care trust investments	695
Total	$3,544
Liabilities:	
Current liabilities	$10
Deferred preneed cemetery revenue	1,185
Deferred preneed cemetery receipts held in trust	2,477
Care trusts corpus	685
Total	$4,357

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The operating results of the discontinued businesses for the three months ended March 31, 2013 and 2014, as well as the gain or loss on the disposal, is presented in the discontinued operations section of the Consolidated Statements of Operations, along with the income tax effect, as follows (in thousands):

	For the Three Months Ended March 31,	
	2013	2014
Revenues	$1,432	$51
Operating income	$338	$20
Gain (loss) on disposition	(583)	909
Income tax benefit (provision)	94	(362)
Income (loss) from discontinued operations	$(151)	$567

5. GOODWILL

Many of the former owners and staff of acquired funeral homes and certain cemeteries have provided high quality service to families for generations. The resulting loyalty often represents a substantial portion of the value of a business. The excess of the purchase price over the fair value of net identifiable assets acquired and liabilities assumed, as determined by management in business acquisition transactions accounted for as purchases, is recorded as goodwill.

The following table presents the changes in goodwill on our Consolidated Balance Sheets (in thousands):

Goodwill as of December 31, 2013	$221,087
Adjustments	(142)
Reclassification of assets held-for-sale	—
Goodwill as of March 31, 2014	$220,945

The adjustment to goodwill in the three months ended March 31, 2014 represents a purchase price allocation adjustment related to a funeral home business acquisition completed in November 2013. Our purchase price allocation for this acquisition is dependent upon certain valuations, which have not progressed to a stage where there is sufficient information to make a definitive measure and allocation of goodwill and other intangible assets. Material revisions to the ongoing current estimates may be necessary when the valuation process is completed, within a year after the closing date of the acquisition.

6. PRENEED TRUST INVESTMENT

Preneed Cemetery Trust Investments

Preneed cemetery trust investments represent trust fund assets that we are generally permitted to withdraw when the merchandise or services are provided. The components of Preneed cemetery trust investments on our Consolidated Balance Sheets at December 31, 2013 and March 31, 2014 are as follows (in thousands):

	December 31, 2013	March 31, 2014
Preneed cemetery trust investments, at fair value	$70,386	$71,510
Less: allowance for contract cancellation	(2,045)	(2,035)
Preneed cemetery trust investments, net	$68,341	$69,475

Upon cancellation of a preneed cemetery contract, a customer is generally entitled to receive a refund of the corpus, and in some cases, some or all of the earnings held in trust. In certain jurisdictions, we are obligated to fund any shortfall if the amounts deposited by the customer exceed the funds in trust, including some or all investment income. As a result, when realized or unrealized losses of a trust result in the trust being under-funded, we assess whether we are responsible for replenishing the corpus of the trust, in which case a loss provision is recorded.

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 our wholly-owned registered investment advisor are included in revenue in the period in which they are earned.

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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 stocks and mortgage backed securities, 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 three months ended March 31, 2014. There are no Level 3 investments in the preneed cemetery trust investment portfolio. See Note 11 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 March 31, 2014 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	$910	$—	$—	$910
Fixed income securities:					
Foreign debt	2	3,938	247	(5)	4,180
Corporate debt	2	30,699	524	(1,385)	29,838
Preferred stock	2	18,475	612	(142)	18,945
Mortgage backed securities	2	1	—	—	1
Common stock	1	13,810	3,378	(585)	16,603
Trust securities		$67,833	$4,761	$(2,117)	$70,477
Accrued investment income		$1,033			$1,033
Preneed cemetery trust investments					$71,510
Fair market value as a percentage of cost					103.9 %

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	6,364
Due in five to ten years	9,873
Thereafter	36,727
Total	$52,964

The cost and fair market values associated with preneed cemetery trust investments at December 31, 2013 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	$1,541	$—	$—	$1,541
Fixed income securities:					
Foreign debt	2	3,460	146	(3)	3,603
Corporate debt	2	32,958	386	(1,150)	32,194
Preferred stock	2	17,754	178	(273)	17,659
Mortgage backed securities	2	1	—	—	1
Common stock	1	12,431	2,362	(267)	14,526
Trust securities		$68,145	$3,072	$(1,693)	$69,524
Accrued investment income		$862			$862
Preneed cemetery trust investments					$70,386
Market value as a percentage of cost					102.0 %

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

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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 Sheets. There will be no impact on earnings unless and until such time as the investment is withdrawn from the trust in accordance with state regulations at an amount that is less than its original basis.

We have determined that the unrealized losses in our preneed cemetery trust investments are considered temporary in nature, as the unrealized losses were due to temporary fluctuations in interest rates and equity prices. The investments are diversified across multiple industry segments using a balanced allocation strategy to minimize long-term risk. At March 31, 2014, we had corporate debt and equity 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 cemetery merchandise and service trust investment unrealized losses, their associated fair market values, and the duration of unrealized losses as of March 31, 2014 and December 31, 2013, are shown in the following tables (in thousands):

	March 31, 2014					
	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	$433	$(5)	$—	$—	$433	$(5)
Corporate debt	5,994	(598)	2,860	(787)	8,854	(1,385)
Preferred stock	4,959	(142)	—	—	4,959	(142)
Common stock	2,850	(570)	98	(15)	2,948	(585)
Total temporary impaired securities	$14,236	$(1,315)	$2,958	$(802)	$17,194	$(2,117)

	December 31, 2013					
	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	$802	$(3)	$—	$—	$802	$(3)
Corporate debt	11,561	(553)	769	(597)	12,330	(1,150)
Preferred stock	9,601	(273)	—	—	9,601	(273)
Common stock	1,077	(171)	705	(96)	1,782	(267)
Total temporary impaired securities	$23,041	$(1,000)	$1,474	$(693)	$24,515	$(1,693)

Preneed cemetery trust investment security transactions recorded in Interest expense in our Consolidated Statements of Operations for the three months ended March 31, 2013 and 2014 were as follows (in thousands):

	For the Three Months Ended March 31,	
	2013	2014
Investment income	$693	$543
Realized gains	38	539
Realized losses	(430)	(188)
Expenses and taxes	(381)	(558)

Increase (decrease) in deferred preneed cemetery receipts held in trust	80	(336)
	$—	$—

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Purchases and sales of investments in the preneed cemetery trusts were as follows (in thousands):

	For the Three Months Ended March 31,	
	2013	2014
Purchases	$(4,161)	$(8,160)
Sales	5,009	8,537

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 funds paid by the customer to us. Preneed funeral trust investments are reduced by the trust earnings we have been allowed to withdraw prior to our performance and amounts received from customers that are not required to be deposited into trust, pursuant to various state laws. The components of Preneed funeral trust investments on our Consolidated Balance Sheets at December 31, 2013 and March 31, 2014 were as follows (in thousands):

	December 31, 2013	March 31, 2014
Preneed funeral trust investments, at market value	$100,005	$103,104
Less: allowance for contract cancellation	(2,861)	(2,900)
Preneed funeral trust investments, net	$97,144	$100,204

Upon cancellation of a preneed funeral contract, a customer is generally entitled to receive a refund of the corpus and some or all of the earnings held in trust. In certain jurisdictions, we are obligated to fund any shortfall if the amounts deposited by the customer exceed the funds in trust, including some or all investment income. As a result, when realized or unrealized losses of a trust result in the trust being under-funded, we assess whether we are responsible for replenishing the corpus of the trust, in which case a loss provision is recorded.

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 our wholly-owned registered investment advisor 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 U.S. agency obligations, 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. During the three months ended March 31, 2014, we reclassified $0.4 million of U.S. Agency obligations from Level 1 investments to Level 2 investments due to reduced trading activity of these securities which caused the fair market price to be determined by other inputs other than quoted prices. There are no Level 3 investments in the preneed funeral trust investment portfolio. See Note 11 for further information of the fair value m