

CARRIAGE SERVICES INC  
Form 10-Q  
October 26, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q  
(Mark One)

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

For the quarterly period ended September 30, 2016  
OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number: 1-11961  
CARRIAGE SERVICES, INC.  
(Exact name of registrant as specified in its charter)

DELAWARE 76-0423828  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) 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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Securities Exchange Act of 1934.

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

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

The number of shares of the registrant's Common Stock, \$.01 par value per share, outstanding as of October 20, 2016 was 16,610,806.



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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

## CARRIAGE SERVICES, INC.

## CONSOLIDATED BALANCE SHEETS

(unaudited and in thousands, except share data)

	December 31, 2015	September 30, 2016
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 535	\$ 855
Accounts receivable, net of allowance for bad debts of \$1,054 in 2015 and \$918 in 2016	18,181	18,023
Inventories	5,654	5,853
Prepaid expenses	4,684	3,599
Other current assets	4,707	838
Total current assets	33,761	29,168
Preneed cemetery trust investments	63,291	65,896
Preneed funeral trust investments	85,553	85,560
Preneed receivables, net of allowance for bad debts of \$2,042 in 2015 and \$2,139 in 2016	27,998	30,579
Receivables from preneed trusts	13,544	13,839
Property, plant and equipment, net of accumulated depreciation of \$103,306 in 2015 and \$109,106 in 2016	214,874	231,465
Cemetery property, net of accumulated amortization of \$30,289 in 2015 and \$33,361 in 2016	75,597	75,692
Goodwill	264,416	267,788
Intangible and other non-current assets	10,978	14,476
Cemetery perpetual care trust investments	43,127	45,048
Total assets	\$ 833,139	\$ 859,511
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	\$ 12,236	\$ 12,633
Accounts payable	7,917	5,857
Other liabilities	524	2,546
Accrued liabilities	16,541	17,714
Total current liabilities	37,218	38,750
Long-term debt, net of current portion	103,495	136,628
Revolving credit facility	91,514	62,073
Convertible subordinated notes due 2021	115,227	118,461
Obligations under capital leases, net of current portion	2,875	2,689
Deferred preneed cemetery revenue	56,721	55,953
Deferred preneed funeral revenue	31,748	33,258
Deferred tax liability	39,956	39,318
Other long-term liabilities	5,531	2,629
Deferred preneed cemetery receipts held in trust	63,291	65,896
Deferred preneed funeral receipts held in trust	85,553	85,560
Care trusts' corpus	42,416	44,345
Total liabilities	675,545	685,560
Commitments and contingencies:		
Stockholders' equity:		

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Common stock, \$.01 par value; 80,000,000 shares authorized and 22,497,873 and 22,458,007 shares issued at December 31, 2015 and September 30, 2016, respectively	225	225
Additional paid-in capital	214,250	215,153
Retained earnings	3,385	18,839
Treasury stock, at cost; 5,849,316 shares at December 31, 2015 and September 30, 2016	(60,266 )	(60,266 )
Total stockholders' equity	157,594	173,951
Total liabilities and stockholders' equity	\$ 833,139	\$ 859,511

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 September 30,		For the Nine Months Ended September 30,	
	2015	2016	2015	2016
Revenues:				
Funeral	\$44,089	\$45,183	\$138,727	\$140,952
Cemetery	14,289	14,957	42,165	44,384
	58,378	60,140	180,892	185,336
Field costs and expenses:				
Funeral	26,798	26,982	82,476	82,546
Cemetery	8,292	8,695	24,040	25,546
Depreciation and amortization	3,019	3,452	8,814	10,359
Regional and unallocated funeral and cemetery costs	2,909	2,783	7,745	8,547
	41,018	41,912	123,075	126,998
Gross profit	17,360	18,228	57,817	58,338
Corporate costs and expenses:				
General and administrative costs and expenses	6,238	6,130	20,294	21,208
Home office depreciation and amortization	418	355	1,310	1,139
	6,656	6,485	21,604	22,347
Operating income	10,704	11,743	36,213	35,991
Interest expense	(2,629 )	(2,903 )	(7,671 )	(8,722 )
Accretion of discount on convertible subordinated notes	(876 )	(981 )	(2,554 )	(2,862 )
Loss on early extinguishment of debt	—	—	—	(567 )
Other income (expense)	52	(285 )	(54 )	20
Income before income taxes	7,251	7,574	25,934	23,860
Provision for income taxes	(2,807 )	(3,030 )	(10,515 )	(9,545 )
Income tax benefit related to state tax returns	—	1,139	—	1,139
Net provision for income taxes	(2,807 )	(1,891 )	(10,515 )	(8,406 )
Net income	\$4,444	\$5,683	\$15,419	\$15,454
Basic earnings per common share:	\$0.24	\$0.34	\$0.84	\$0.93
Diluted earnings per common share:	\$0.24	\$0.33	\$0.82	\$0.91
Dividends declared per common share	\$0.025	\$0.050	\$0.075	\$0.100
Weighted average number of common and common equivalent shares outstanding:				
Basic	17,874	16,529	18,115	16,502
Diluted	18,083	17,101	18,588	16,962

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 Nine Months Ended September 30, 2015	2016
Cash flows from operating activities:		
Net income	\$ 15,419	\$ 15,454
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,124	11,498
Provision for losses on accounts receivable	1,332	1,522
Stock-based compensation expense	3,448	2,645
Deferred income tax expense	2,065	3,618
Amortization of deferred financing costs	688	622
Accretion of discount on convertible subordinated notes	2,554	2,862
Loss on early extinguishment of debt	—	567
Net (gain) loss on sale and disposal of other assets	(49 )	186
Impairment of intangible assets	—	145
Changes in operating assets and liabilities that provided (required) cash:		
Accounts and preneed receivables	(779 )	(3,945 )
Inventories and other current assets	3,277	682
Intangible and other non-current assets	114	386
Preneed funeral and cemetery trust investments	21,234	(4,828 )
Accounts payable	368	(2,149 )
Accrued and other liabilities	4,408	(268 )
	432	742

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Deferred preneed funeral and cemetery revenue			
Deferred preneed funeral and cemetery receipts held in trust	(21,647	)	4,541
Net cash provided by operating activities	42,988		34,280
Cash flows from investing activities:			
Acquisitions and land for new construction	(4,250	)	(15,056
Purchase of land and buildings previously leased	(6,080	)	(6,258
Net proceeds from the sale of other assets	65		955
Capital expenditures	(22,823	)	(12,039
Net cash used in investing activities	(33,088	)	(32,398
Cash flows from financing activities:			
Borrowings from the revolving credit facility	56,200		45,500
Payments against the revolving credit facility	(33,700	)	(74,800
Borrowings from the term loan	—		39,063
Payments against the term loan	(7,032	)	(8,438
Payments on other long-term debt and obligations under capital leases	(679	)	(987
Proceeds from the exercise of stock options and employee stock purchase plan contributions	575		686
Dividends on common stock	(1,385	)	(1,662
Payment of loan origination costs related to the credit facility	(13	)	(717
Purchase of treasury stock	(23,940	)	—
Excess tax benefit (deficiency) of equity compensation	57		(207
	(9,917	)	(1,562

Net cash used in  
financing activities

Net increase (decrease) in cash and cash equivalents	(17	)	320
Cash and cash equivalents at beginning of period	413		535
Cash and cash equivalents at end of period	\$	396	\$ 855

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 September 30, 2016, we operated 169 funeral homes in 27 states and 32 cemeteries in 11 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 that provide interment rights (grave sites and mausoleums) and related merchandise, such as markers and memorials.

Principles of Consolidation and Interim Condensed Disclosures

Our unaudited consolidated financial statements include the Company and its subsidiaries. All intercompany balances and transactions have been eliminated. Our interim consolidated financial statements are unaudited but include all adjustments, which consist of normal, recurring accruals, that are necessary for a fair presentation of our financial position and results of operations as of and for the interim periods presented. Our unaudited consolidated financial statements have been prepared in a manner consistent with the accounting principles described in our Annual Report on Form 10-K for the year ended December 31, 2015 unless otherwise disclosed herein, and should be read in conjunction therewith.

Reclassifications

Certain reclassifications have been made to prior period amounts to conform to the current period financial statement presentation with no effect on our previously reported results of operations, consolidated financial position, or cash flows.

Cash and Cash Equivalents

We consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Use of Estimates

The preparation of our Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, 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. We recorded amortization expense for cemetery property of approximately \$0.9 million for both the three months ended September 30, 2015 and 2016 and \$2.5 million and \$3.1 million for the nine months ended September 30, 2015 and 2016, respectively. 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. We also monitor changes in delinquency rates 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. Preneed selling costs consist of sales commissions that we pay our sales counselors and other direct related cost of originating preneed sales contracts. These costs are expensed when incurred.

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 September 30, 2016, CSV RIA provided these services to two institutions, which have custody of 78% 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.

Accounts receivable included approximately \$8.2 million and \$6.9 million of funeral receivables at December 31, 2015 and September 30, 2016, respectively and \$9.7 million and \$10.3 million of cemetery receivables at December 31, 2015 and September 30, 2016, respectively. For 2015 and 2016, accounts receivable also included minor amounts of other receivables. Non-current preneed receivables represents payments expected to be received beyond one year from the balance sheet date. Non-current preneed receivables consisted of approximately \$7.3 million and \$8.1 million of funeral receivables at December 31, 2015 and September 30, 2016, respectively, and \$20.7 million and \$22.5 million of cemetery receivables at December 31, 2015 and September 30, 2016, respectively. Bad debt expense totaled approximately \$0.5 million for both the three months ended September 30, 2015 and 2016, and \$1.3 million and \$1.0 million for the nine months ended September 30, 2015 and 2016, 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, 2015 and September 30, 2016:

	December 31, 2015	September 30, 2016
	(in thousands)	
Land	\$65,433	\$74,797
Buildings and improvements	180,804	190,910
Furniture, equipment and automobiles	71,943	74,864
Property, plant and equipment, at cost	318,180	340,571
Less: accumulated depreciation	(103,306 )	(109,106 )
Property, plant and equipment, net	\$214,874	\$231,465

We recorded depreciation expense of approximately \$2.6 million and \$2.9 million for the three months ended September 30, 2015 and 2016, respectively, and \$7.6 million and \$8.4 million for the nine months ended September 30, 2015 and 2016, respectively. During the nine months ended September 30, 2016, we acquired real estate for \$2.7 million for funeral home expansion projects and we purchased land and buildings at four funeral homes that were previously leased for approximately \$6.3 million. During the nine months ended September 30, 2016, we acquired \$8.4 million of property, plant and equipment in connection with two funeral home businesses acquired in May 2016 and one funeral home business acquired in September 2016, as further discussed in Note 3 to the Consolidated Financial Statements included herein.

#### 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 home businesses. Goodwill is tested annually for impairment by assessing the fair value of each of our reporting units. The funeral segment reporting units consist of our East, Central and West regions in the United States and we performed our annual impairment test of goodwill using information as of August 31, 2016.

Under current guidance, we are permitted to first assess qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. We conducted qualitative assessments in 2014 and 2015; however, for our 2016 annual impairment test, we performed the two-step goodwill impairment test. Our intent is to perform the two-step test at least once every three years unless certain indicators or events suggest otherwise.

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The two-step goodwill impairment test involves estimates and management judgment. In the first step of our goodwill impairment testing, we compare the fair value of each reporting unit to its carrying value, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, the goodwill of that reporting unit is not considered impaired, and the second step is not required. We determine fair value for each reporting unit using both an income approach, weighted 90%, and a market approach, weighted 10%. Our methodology for determining an income-based fair value was based on discounting projected future cash flows. The projected future cash flows include assumptions concerning future operating performance and economic condition that may differ from actual future cash flows discounted at a weighted average cost of capital for the Company based on market participant assumptions. Our methodology for determining a market approach fair value utilized the guideline public company method, in which we relied on market multiples of comparable companies operating in the same industry as the individual reporting units. In accordance with the guidance, if the fair value of the reporting unit is less than its carrying amount, the second step of the goodwill impairment testing needs to be performed. This step compares the implied fair value of goodwill to the carrying amount of the reporting unit's goodwill, and if the carrying amount exceeds the implied value, an impairment charge is recorded in an amount equal to the difference. For our 2016 annual impairment test, we performed the first step of our goodwill impairment testing and concluded that there was no impairment to goodwill for any of our reporting units.

In addition to our annual review, we assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value of a reporting unit may be greater than fair value. Factors that could trigger an interim impairment review include, but are not limited to, significant adverse changes in the business climate which may be indicated by a decline in our market capitalization or decline in operating results. No impairments were recorded to our goodwill during the three and nine months ended September 30, 2015 and 2016.

Intangible Assets

Our intangible assets include tradenames resulting from acquisitions and are included in Deferred costs 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.

Under current guidance, we are permitted to first assess qualitative factors to determine whether it is more-likely-than-not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with the guidance.

The Company elected to change the annual assessment date for indefinite lived intangible assets from December 31<sup>st</sup> to August 31<sup>st</sup> because the change in date aligns with the Company's goodwill impairment test, which should create a synergy and enhance the quality of our indefinite lived intangible assets impairment analysis. We conducted qualitative assessments in 2014 and 2015; however, for our 2016 annual impairment test, we performed our quantitative impairment test using the relief from royalty method, using information as of August 31, 2016. Our intent is to perform the quantitative impairment test at least once every three years unless certain indicators or events suggest otherwise.

Our intangible asset impairment test involves estimates and management judgment. Under the relief from royalty method, the value of the tradename is measured through the value of the royalties that the Company is relieved from paying due to its ownership of the asset. We determine the fair value of the assets by discounting the cash flows that represent a savings in lieu of paying a royalty fee for use of the tradename. The discounted cash flow valuation uses projections of future cash flows and includes assumptions concerning future operating performance and economic conditions that may differ from actual future cash flows and the determination and application of an appropriate royalty rate and discount rate. To estimate the royalty rates for the individual tradename, we mainly relied on the profit split method, but also considered the comparable third-party license agreements and the return on asset method. A scorecard was used to assess the relative strength of the individual tradename to further adjust the royalty rates selected under the profit-split method for qualitative factors. For our 2016 annual impairment test, we performed our quantitative impairment testing and concluded that there was no impairment to intangible assets.

In addition to our annual review, we assess the impairment of intangible assets whenever certain events or changes in circumstances indicate that the carrying value of the intangible asset may be greater than the fair value. Factors that could trigger an interim impairment review include, but are not limited to, significant under-performance relative to historical or projected future operating results and significant negative industry or economic trends. During the three months ended September 30, 2016, we recorded an impairment to tradenames of \$145,000 related to a funeral home business held for sale as the carrying value exceeded fair value. We had no such impairment for three months ended September 30, 2015. No other impairments were recorded to our intangible assets during the three and nine months ended September 30, 2015 and 2016.

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### Presentation of Debt Issuance Costs

Effective January 1, 2016, we adopted the Financial Accounting Standards Board's ("FASB") new guidance on simplifying the presentation of debt issuance costs. In April 2015, the FASB issued Accounting Standards Update ("ASU"), Imputation of Interest (Subtopic 835-30), which requires that entities that have historically presented debt issuance costs as an asset, related to a recognized debt liability, will be required to present those costs as a direct deduction from the carrying value of the related debt liability. This presentation resulted in debt issuance costs being presented in the same way debt discounts have historically been addressed. Debt issuances costs of \$4.2 million and \$3.7 million have been presented as a deduction from the carrying value of the related liabilities in our Consolidated Balance Sheets as of December 31, 2015 and September 30, 2016, respectively. The amounts related to our Credit Facility were \$1.4 million and \$1.3 million as of December 31, 2015 and September 30, 2016, respectively. The amounts related to our Convertible Notes were \$2.8 million and \$2.4 million as of December 31, 2015 and September 30, 2016, respectively.

### Business Combinations

Effective January 1, 2016, we adopted the FASB new guidance on simplifying the accounting for measurement-period adjustments for Business Combinations. In September 2015, the FASB issued ASU, Business Combinations (Topic 805), which requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. These include the effect on earnings of changes in depreciation, amortization, or other income effects as if the accounting had been completed at the acquisition date. The entity is required to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in the current period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. Our adoption of this ASU did not have a material effect on our financial statements.

During the third quarter of 2016, we acquired one funeral home business in Madera, California. The pro forma impact of the acquisition on prior periods is not presented, as the impact is not material to our reported results. During the nine months ended September 30, 2016, we acquired three funeral homes. The pro forma impact of these acquisitions on prior periods is not presented, as the impact is not material to our reported results. See Note 3 to the Consolidated Financial Statements included herein for further information concerning this acquisition.

### Extraordinary and Unusual Items

Effective January 1, 2016, we adopted the FASB new guidance on extraordinary and unusual items. In January 2015, the FASB issued ASU, Extraordinary and Unusual Items (Subtopic 225-20). This ASU eliminates the concept of reporting extraordinary items. Preparers will not have to assess whether a particular event or transaction is extraordinary. The presentation and disclosure guidance for items that are unusual in nature or occur infrequently will be retained and will be expanded to include such items. Our adoption of this ASU did not have a material effect on our financial statements.

### Income Taxes

We and our subsidiaries file a consolidated U.S. Federal income tax return, separate income tax returns in 14 states in which we operate and combined or unitary income tax returns in 13 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.

Income tax expense during interim periods is based on our estimated annual effective income tax rate plus any discrete items, which are recorded in the period in which they occur. Discrete items include, among others, such

events as changes in estimates due to the finalization of tax returns, tax audit settlements, and increases or decreases in valuation allowances on deferred tax assets.

Income tax expense was \$1.9 million for the three months ended September 30, 2016 compared to \$2.8 million for the three months ended September 30, 2015. We recorded income taxes at the estimated effective rate, before discrete items, of 40.0% for the three months ended September 30, 2016 compared to 38.7% for the three months ended September 30, 2015. Income tax expense was \$8.4 million for the nine months ended September 30, 2016 compared to \$10.5 million for the nine months ended

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September 30, 2015. We recorded income taxes at the estimated effective tax rate, before discrete items, of 40.0% for both the nine months ended September 30, 2016 and 2015.

During the third quarter of 2016, we recognized a tax benefit of \$1.1 million which reduced our effective tax rate to 35.2% for the nine months ended September 30, 2016. The following items affected our effective tax rate for the nine months ended September 30, 2016:

We recorded an income tax benefit as a result of a favorable settlement of uncertain tax positions in the state of California and an income tax benefit related to the conclusion of a “no change” Internal Revenue Service audit of our 2013 tax year.

We recorded an income tax benefit related to the increase in the overall accumulated deferred tax asset caused by the imposition of a unitary tax regime in the state of New York effective January 1, 2015, impacting the state return filed in September 2016.

We recorded an income tax benefit related to state bonus depreciation as a result of finalization of state returns.

We recorded other expense adjustments related to our valuation allowance and certain interim rate changes.

Subsequent Events

Management evaluated events and transactions during the period subsequent to September 30, 2016 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 17 to the Consolidated Financial Statements included herein.

2.RECENTLY ISSUED ACCOUNTING STANDARDS

Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued ASU, Statement of Cash Flows (Topic 230). This ASU applies to all entities that are required to present a statement of cash flows under Topic 230. The amendments provide guidance on the following eight specific cash flow issues: debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims and corporate-owned life insurance policies, distributions received from equity method investees, beneficial interests in securitization transactions and separately identifiable cash flows and application of the predominance principle. This ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with earlier application permitted for all entities. An entity will apply the amendments in this ASU using a retrospective transition method to each period presented. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2018 and are currently evaluating the impact the adoption of this new accounting standard will have on our Consolidated Financial Statements.

Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU, Financial Instruments—Credit Losses (Topic 326). This ASU applies to all entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash that issue share-based payment awards to their employees. This ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, with earlier application permitted for all entities. An entity will apply the amendments in this ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (that is, a modified-retrospective approach). A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2020 and are currently evaluating the impact the adoption of this new accounting standard will have on our Consolidated Financial Statements.

Table of Contents**Simplifying Share-Based Payment Accounting**

In March 2016, the FASB issued ASU, Compensation—Stock Compensation (Topic 718). This ASU applies to all entities that issue share-based payment awards to their employees. The amendments in this ASU involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with earlier application permitted for all entities. Amendments related to the presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet the minimum statutory withholding requirement should be applied retrospectively. Amendments requiring recognition of excess tax benefits and tax deficiencies in the income statement and the practical expedient for estimating expected term should be applied prospectively. An entity may elect to apply the amendments related to the presentation of excess tax benefits on the statement of cash flows using either a prospective transition method or a retrospective transition method. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2017 and are currently evaluating the impact the adoption of this new accounting standard will have on our Consolidated Financial Statements.

**Leases**

In February 2016, the FASB issued ASU, Leases (Topic 842). This ASU addresses certain aspects of recognition, presentation, and disclosure of leases and applies to all entities that enter into a lease, with some specified scope exemptions. The amendments in this ASU aim to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with earlier application permitted for all entities. Both lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach, which recognizes the cumulative effect of initially applying the standard as an adjustment to retained earnings at the date of initial application. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2019 and are currently evaluating the impact the adoption of this new accounting standard will have on our Consolidated Financial Statements.

**3. ACQUISITIONS**

Our growth strategy includes the execution of our Strategic Acquisition Model. We assess the strategic positioning of acquisition candidates based on certain criteria, which include volume and price trends, size of business, size of market, competitive standing, demographics, strength of brand and barriers to entry. The value of the acquisition candidates is based on the local market competitive dynamic which allows for appropriate and differentiating enterprise valuations and flexibility to customize the transactions.

On May 31, 2016, we acquired two funeral home businesses in Houston, Texas for approximately \$10.2 million. The purchase price consisted of \$6.7 million paid in cash at closing and \$6.5 million of deferred purchase price payments. The net present value of such future deferred purchase price payments for these two funeral home businesses was \$3.5 million, which is included in Long-term debt, net of current portion on our Consolidated Balance Sheets. The deferred purchase price payments are being paid in 80 equal quarterly installments of \$81,250 which commenced on the closing date and then each September 1, December 1, March 1 and June 1 for the next 20 years.

On September 20, 2016, we acquired a funeral home business in Madera, California for \$5.65 million in cash. The pro forma impact of these two acquisitions on prior periods is not presented, as the impact is not material to our reported results. The results of the acquired businesses are include in the Company's results from the date of acquisition.

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

	Purchase
	Price
Cash paid	\$ 12,350
Deferred payments	3,500
Purchase Price	\$ 15,850



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

	Purchase Price Allocation
Current assets	\$ 182
Property, plant & equipment	8,356
Goodwill	3,372
Intangible and other non-current assets	4,029
Assumed liabilities	(89 )
Purchase Price	\$ 15,850

The intangible and other non-current assets relate to the fair value of tradenames and prepaid agreements not-to-compete, and the assumed liabilities relate to the obligations associated with certain financed automobiles we acquired.

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

Acquisition Date	Type of Business	Market	Assets Acquired (Excluding Goodwill)	Goodwill Recorded	Liabilities and Debt Assumed
May 31, 2016	Two Funeral Homes	Houston, TX	\$ 9.5	\$ 0.8	\$ (0.1 )
September 20, 2016	One Funeral Home	Madera, CA	\$ 3.1	\$ 2.5	\$ —

#### 4. GOODWILL

Many of the former owners and staff of acquired funeral homes 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. See Note 1 to the Consolidated Financial Statements included herein, for a discussion of the methodology used for the annual goodwill impairment test.

The following table presents the changes in goodwill on our Consolidated Balance Sheets during the nine months ended September 30, 2016 (in thousands):

Goodwill as of December 31, 2015	\$264,416
Increase in goodwill related to acquisitions	3,372
Goodwill as of September 30, 2016	\$267,788

The \$3.4 million increase in goodwill related to acquisitions represents the goodwill recorded in connection with the two funeral home businesses acquired in May 2016 and the funeral home business acquired in September 2016 described in Note 3 to the Consolidated Financial Statements included herein. Our purchase price allocation for these acquisitions 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 intangible assets, as discussed in Note 10 to the Consolidated Financial Statements included herein. Revisions to the ongoing current estimates may be necessary when the valuation process is completed, which we expect to occur within a year after the respective acquisition closing date.

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## 5. PRENEED TRUST INVESTMENTS

## Preneed Cemetery Trust Investments

Preneed cemetery trust investments represent trust fund assets that we are permitted to withdraw as services and merchandise are provided to customers. Preneed cemetery contracts are secured by payments from customers, less amounts not required by law to be deposited into trust. Preneed cemetery trust investments are reduced by the trust earnings we have been allowed to withdraw in certain states prior to our performance.

The components of Preneed cemetery trust investments on our Consolidated Balance Sheets at December 31, 2015 and September 30, 2016 were as follows (in thousands):

	December 31, September 30,	
	2015	2016
Preneed cemetery trust investments, at market value	\$ 65,486	\$ 68,009
Less: allowance for contract cancellation	(2,195 )	(2,113 )
Preneed cemetery trust investments, net	\$ 63,291	\$ 65,896

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 may be 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. At September 30, 2016, none of our preneed cemetery trust investments were under-funded.

Earnings from our preneed cemetery trust investments are recognized in revenue when a service is performed or merchandise is delivered. Trust management fees charged by CSV RIA are included 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 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 municipal bonds, foreign debt, corporate debt, preferred stocks, mortgage backed securities and fixed income mutual funds, all of which are classified within Level 2 of the valuation hierarchy. We review and update our fair value hierarchy classifications quarterly. There were no transfers between Levels 1 and 2 in the three and nine months ended September 30, 2016. There are no Level 3 investments in the preneed cemetery trust investment portfolio. See Note 9 to the Consolidated Financial Statements included herein for further information on the fair value measurement and the three-level hierarchy.

The cost and fair market values associated with preneed cemetery trust investments at September 30, 2016 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$7,888	\$ —	\$ —	\$ 7,888
Fixed income securities:					
Municipal bonds	2	498	—	—	498
Foreign debt	2	8,614	268	(741 )	8,141
Corporate debt	2	23,717	1,790	(1,413 )	24,094
Preferred stock	2	16,371	30	(704 )	15,697
Mortgage backed securities	2	245	—	(16 )	229
Common stock	1	11,888	440	(3,144 )	9,184
Mutual funds:					
Fixed Income	2	1,229	129	—	1,358
Trust securities		\$70,450	\$ 2,657	\$ (6,018 )	\$ 67,089
Accrued investment income		\$920			\$920
Preneed cemetery trust investments					\$ 68,009

Market value as a percentage of cost

95.2 %

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

Due in one year or less	\$303
Due in one to five years	8,065
Due in five to ten years	5,854
Thereafter	34,437
Total	\$48,659

The cost and fair market values associated with preneed cemetery trust investments at December 31, 2015 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$8,296	\$ —	\$ —	\$8,296
Fixed income securities:					
Municipal bonds	2	458	—	(63 )	395
Foreign debt	2	4,803	—	(695 )	4,108
Corporate debt	2	22,968	85	(4,279 )	18,774
Preferred stock	2	16,236	29	(885 )	15,380
Common stock	1	20,387	682	(3,161 )	17,908
Trust securities		\$73,148	\$ 796	\$ (9,083 )	\$64,861
Accrued investment income		\$625			\$625
Preneed cemetery trust investments					\$65,486
Market value as a percentage of cost					88.7 %

We determine whether or not the assets in the preneed cemetery trust investments have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis of the investment due to an other-than-temporary impairment is likewise recorded as a reduction in Deferred preneed cemetery receipts held in trust on our Consolidated Balance Sheets. In the three months ended September 30, 2016, we recorded a \$0.1 million impairment for other-than-temporary declines in the fair value related to unrealized losses on certain investments. We did not record any impairments in the three months ended September 30, 2015. In the nine months ended September 30, 2015 and 2016, we recorded a \$0.7 million and \$0.8 million impairment for other-than-temporary declines in the fair value related to unrealized losses on certain investments, respectively. There is no impact on earnings until such time that the loss is realized in the trusts, allocated to preneed contracts and the services are performed or the merchandise is delivered causing the contract to be withdrawn from the trust in accordance with state regulations.

At September 30, 2016, we had certain investments within our preneed cemetery trust investments that had tax lots in loss positions for more than one year. Based on our analyses of these securities, the companies' businesses and current market conditions, we determined that these investment losses were temporary in nature. Our cemetery merchandise and service trust investment unrealized losses, their associated fair market values, and the duration of unrealized losses as of September 30, 2016 and December 31, 2015, are shown in the following tables (in thousands):

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	September 30, 2016					
	In Loss Position Less than 12 months		In Loss Position Greater than 12 months		Total	
	Fair Market Value	Unrealized Losses	Fair Market Value	Unrealized Losses	Fair Market Value	Unrealized Losses
Fixed income securities:						
Foreign debt	2,419	(138 )	2,909	(603 )	5,328	(741 )
Corporate debt	6,599	(197 )	4,707	(1,216 )	11,306	(1,413 )
Preferred stock	1,711	(10 )	11,830	(694 )	13,541	(704 )
Mortgage backed securities	229	(16 )	—	—	229	(16 )
Common stock	4,740	(1,407 )	2,677	(1,737 )	7,417	(3,144 )
Total temporary impaired securities	\$15,698	\$(1,768 )	\$22,123	\$(4,250 )	\$37,821	\$(6,018 )

	December 31, 2015					
	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:						
Municipal bonds	\$395	\$(63 )	\$—	\$—	\$395	\$(63 )
Foreign debt	3,680	(384 )	406	(312 )	4,086	(696 )
Corporate debt	14,468	(2,992 )	3,056	(1,287 )	17,524	(4,279 )
Preferred stock	10,285	(436 )	5,168	(448 )	15,453	(884 )
Common stock	12,029	(1,989 )	3,564	(1,172 )	15,593	(3,161 )
Total temporary impaired securities	\$40,857	\$(5,864 )	\$12,194	\$(3,219 )	\$53,051	\$(9,083 )

Preneed cemetery trust investment security transactions recorded in Interest expense on our Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2016 were as follows (in thousands):

	For the Three Months Ended September 30,			
	2015	2016	2015	2016
Investment income	\$471	\$578	\$1,762	\$1,546
Realized gains	1,170	126	2,844	415
Realized losses	(276 )	(673 )	(1,166 )	(4,081 )
Expenses and taxes	(361 )	(139 )	(1,455 )	(832 )
Decrease (increase) in deferred preneed cemetery receipts held in trust	(1,004 )	108	(1,985 )	2,952
	\$—	\$—	\$—	\$—

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2015	2016	2015	2016
Purchases	\$(11,719)	\$(1,434)	\$(24,575)	\$(19,540)
Sales	\$4,417	\$5,973	\$14,610	\$18,003



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## Preneed Funeral Trust Investments

Preneed funeral trust investments represent trust fund assets that we are permitted to withdraw as services and merchandise are provided to customers. Preneed funeral contracts are secured by payments from customers, less amounts not required by law to be deposited into trust. Preneed funeral trust investments are reduced by the trust earnings we have been allowed to withdraw in certain states prior to our performance.

The components of Preneed funeral trust investments on our Consolidated Balance Sheets at December 31, 2015 and September 30, 2016 were as follows (in thousands):

	December 31, September 30,	
	2015	2016
Preneed funeral trust investments, at market value	\$ 88,444	\$ 88,281
Less: allowance for contract cancellation	(2,891 )	(2,721 )
Preneed funeral trust investments, net	\$ 85,553	\$ 85,560

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 may be 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. At September 30, 2016, none of our preneed funeral trust investments were under-funded.

Earnings from our preneed funeral trust investments are recognized in revenue when a service is performed or merchandise is delivered. Trust management fees charged by CSV RIA are included in revenue in the period in which they are earned.

Where quoted prices are available in an active market, investments held by the trusts are classified as Level 1 investments pursuant to the three-level valuation hierarchy. Our Level 1 investments include cash, U.S. treasury debt and common stock. 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 municipal bonds, foreign debt, corporate debt, preferred stocks, mortgage backed securities and fixed income mutual funds and other investments, all of which are classified within Level 2 of the valuation hierarchy. We review and update our fair value hierarchy classifications quarterly. There were no transfers between Levels 1 and 2 for the three and nine months ended September 30, 2016. There are no Level 3 investments in the preneed funeral trust investment portfolio. See Note 9 to the Consolidated Financial Statements included herein for further information on the fair value measurement and the three-level hierarchy.

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The cost and fair market values associated with preneed funeral trust investments at September 30, 2016 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$21,030	\$ —	\$ —	\$21,030
Fixed income securities:					
U.S treasury debt	1	1,491	48	—	1,539
Municipal bonds	2	441	—	—	441
Foreign debt	2	8,640	255	(748)	8,147
Corporate debt	2	24,292	1,800	(1,429)	24,663
Preferred stock	2	16,815	103	(705)	16,213
Mortgage backed securities	2	409	4	(17)	396
Common stock	1	11,981	413	(3,198)	9,196
Mutual funds:					
Fixed income	2	2,139	138	(19)	2,258
Other investments	2	3,468	—	—	3,468
Trust securities		\$90,706	\$ 2,761	\$(6,116)	\$ 87,351
Accrued investment income		\$930			\$930
Preneed funeral trust investments					\$88,281
Market value as a percentage of cost					96.3 %

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

Due in one year or less	\$318
Due in one to five years	9,348
Due in five to ten years	6,061
Thereafter	35,672
Total	\$51,399

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The cost and fair market values associated with preneed funeral trust investments at December 31, 2015 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$21,458	\$ —	\$ —	\$21,458
Fixed income securities:					
U.S. treasury debt	1	1,492	24	(12 )	1,504
Municipal bonds	2	478	—	(66 )	412
Foreign debt	2	4,938	—	(711 )	4,227
Corporate debt	2	24,787	133	(4,711 )	20,209
Preferred stock	2	17,496	158	(914 )	16,740
Mortgage backed securities	2	273	4	(4 )	273
Common stock	1	20,864	738	(3,114 )	18,488
Mutual funds:					
Fixed income	2	959	—	(82 )	877
Other investments	2	3,598	—	(30 )	3,568
Trust securities		\$96,343	\$ 1,057	\$ (9,644 )	\$ 87,756
Accrued investment income		\$688			\$688
Preneed funeral trust investments					\$88,444
Market value as a percentage of cost					91.1 %

We determine whether or not the assets in the preneed funeral trust investments have other-than-temporary impairments on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis of the investment due to an other-than-temporary impairment is likewise recorded as a reduction to Deferred preneed funeral receipts held in trust on our Consolidated Balance Sheets. In the three months ended September 30, 2016, we recorded a \$0.1 million impairment for other-than-temporary declines in the fair value related to unrealized losses on certain investments. We did not record any impairments in the three months ended September 30, 2015. In the nine months ended September 30, 2015 and 2016, we recorded a \$0.6 million and \$0.9 million impairment for other-than-temporary declines in the fair value related to unrealized losses on certain investments, respectively. There is no impact on earnings until such time that the loss is realized in the trusts, allocated to preneed contracts and the services are performed or the merchandise is delivered causing the contract to be withdrawn from the trust in accordance with state regulations.

At September 30, 2016, we had certain investments within our preneed funeral trust investments that had tax lots in loss positions for more than one year. Based on our analyses of these securities, the companies' businesses and current market conditions, we determined that these investment losses were temporary in nature.

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Our preneed funeral trust investment unrealized losses, their associated fair market values, and the duration of unrealized losses as of September 30, 2016 and December 31, 2015 are shown in the following tables (in thousands):

	September 30, 2016					
	In Loss Position Less than 12 months		In Loss Position Greater than 12 months		Total	
	Fair Market Value	Unrealized Losses	Fair Market Value	Unrealized Losses	Fair Market Value	Unrealized Losses
Fixed income securities:						
Foreign debt	2,492	(141 )	2,901	(608 )	5,393	(749 )
Corporate debt	6,673	(199 )	4,759	(1,228 )	11,432	(1,427 )
Preferred stock	1,749	(10 )	11,729	(695 )	13,478	(705 )
Mortgage backed securities	241	(16 )	13	(1 )	254	(17 )
Mutual funds:						
Equity	4,928	(1,466 )	2,589	(1,732 )	7,517	(3,198 )
Fixed income	301	(4 )	439	(16 )	740	(20 )
Total temporary impaired securities	\$16,384	\$(1,836 )	\$22,430	\$(4,280 )	\$38,814	\$(6,116 )
	December 31, 2015					
	In Loss Position Less than 12 months		In Loss Position Greater than 12 months		Total	
	Fair Market Value	Unrealized Losses	Fair Market Value	Unrealized Losses	Fair Market Value	Unrealized Losses
Fixed income securities:						
U.S. debt	\$—	\$—	\$1,504	\$(12 )	\$1,504	\$(12 )
Municipal bonds	413	(66 )	—	—	413	(66 )
Foreign debt	3,763	(392 )	416	(319 )	4,179	(711 )
Corporate debt	15,929	(3,294 )	3,364	(1,417 )	19,293	(4,711 )
Preferred stock	10,623	(451 )	5,338	(463 )	15,961	(914 )
Mortgage backed securities	—	—	272	(4 )	272	(4 )
Mutual funds:						
Equity	11,848	(1,959 )	3,510	(1,154 )	15,358	(3,113 )
Fixed income	1	—	876	(82 )	877	(82 )
Other investments	—	—	42	(31 )	42	(31 )
Total temporary impaired securities	\$42,577	\$(6,162 )	\$15,322	\$(3,482 )	\$57,899	\$(9,644 )

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Preneed funeral trust investment security transactions recorded in Interest expense on the Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2016 were as follows (in thousands):

	For the Three			
	Months Ended September 30,		For the Nine Months Ended September 30,	
	2015	2016	2015	2016
Investment income	\$554	\$596	\$1,982	\$1,639
Realized gains	1,218	131	3,791	525
Realized losses	(504)	(716)	(1,374)	(4,090)
Expenses and taxes	140	(253)	(694)	(946)
Decrease (increase) in deferred preneed funeral receipts held in trust	(1,408)	242	(3,705)	2,872
	\$—	\$—	\$—	\$—

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2015	2016	2015	2016
Purchases	\$ (12,323)	\$ (1,486)	\$ (23,668)	\$ (19,917)
Sales	\$ 10,998	\$ 6,336	\$ 33,736	\$ 19,005

#### 6. PRENEED CEMETERY RECEIVABLES

Preneed sales of cemetery interment rights and related products and services are usually financed through interest-bearing installment sales contracts, generally with terms of up to five years with such interest income reflected as Preneed cemetery finance charges. In substantially all cases, we receive an initial down payment at the time the contract is signed. At September 30, 2016, our total financed preneed receivables were \$39.1 million, of which \$28.7 million and \$10.4 million were for cemetery interment rights and for merchandise and services respectively. These amounts are presented on our consolidated balance sheet as \$11.7 million within Accounts receivable and \$27.4 million within Preneed receivables and exclude unearned finance charges and allowance for contract cancellations. The unearned finance charges associated with these receivables were \$5.2 million and \$5.7 million at December 31, 2015 and September 30, 2016, respectively.

We determine an allowance for customer cancellations and refunds on contracts in which revenue has been recognized on sales of cemetery interment rights. We have a collections policy where past due notifications are sent to the customer beginning at 15 days past due and periodically thereafter until the contract is cancelled or payment is received. We reserve 100% of the receivables on contracts in which the revenue has been recognized and payments are 90 days past due or more, which was approximately 4.3% of the total receivables on recognized sales at September 30, 2016. An allowance is recorded at the date that the contract is executed and periodically adjusted thereafter based upon actual collection experience at the business level. For the nine months ended September 30, 2016, the change in the allowance for contract cancellations was as follows (in thousands):

	September 30, 2016
Beginning balance	\$ 1,765
Write-offs and cancellations	(1,047)
Provision	1,055
Ending balance	\$ 1,773

The aging of past due financing receivables as of September 30, 2016 was as follows (in thousands):

31-60 Past Due	61-90 Past Due	91-120 Past Due	>120 Past Due	Total Past Due	Total Current	Total Financing Receivables

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Recognized revenue	\$ 560	\$ 402	\$ 175	\$ 1,056	\$ 2,193	\$26,127	\$ 28,320
Deferred revenue	218	148	70	316	752	9,985	10,737
Total contracts	\$ 778	\$ 550	\$ 245	\$ 1,372	\$ 2,945	\$36,112	\$ 39,057

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Table of Contents**7. RECEIVABLES FROM PRENEED TRUSTS**

The receivables from preneed trusts represent assets in trusts which are controlled and operated by third parties in which we do not have a controlling financial interest (less than 50%) in the trust assets. We account for these investments at cost. As of December 31, 2015 and September 30, 2016, receivables from preneed trusts were as follows (in thousands):

	December 31, September 30,	
	2015	2016
Preneed trust funds, at cost	\$ 13,963	\$ 14,267
Less: allowance for contract cancellation	(419 )	(428 )
Receivables from preneed trusts, net	\$ 13,544	\$ 13,839

The following summary reflects the composition of the assets held in trust and controlled by third parties to satisfy our future obligations under preneed arrangements related to the preceding contracts at September 30, 2016 and December 31, 2015. The cost basis includes reinvested interest and dividends that have been earned on the trust assets. Fair value includes the unrealized gains and losses on trust assets.

	Historical Cost Basis	Fair Value
	(in thousands)	
As of September 30, 2016		
Cash and cash equivalents	\$3,382	\$ 3,382
Fixed income investments	8,453	8,452
Mutual funds and common stocks	2,417	2,477
Annuities	15	15
Total	\$14,267	\$ 14,326

	Historical Cost Basis	Fair Value
	(in thousands)	
As of December 31, 2015		
Cash and cash equivalents	\$2,898	\$ 2,898
Fixed income investments	8,423	8,426
Mutual funds and common stocks	2,626	2,625
Annuities	16	16
Total	\$13,963	\$ 13,965

**8. CEMETERY PERPETUAL CARE TRUST INVESTMENTS**

Care trusts' corpus on our Consolidated Balance Sheets represent the corpus of those trusts plus undistributed income. The components of Care trusts' corpus as of December 31, 2015 and September 30, 2016 were as follows (in thousands):

	December 31, September 30,	
	2015	2016
Trust assets, at market value	\$ 43,127	\$ 45,048
Obligations due from trust	(711 )	(703 )
Care trusts' corpus	\$ 42,416	\$ 44,345

We are required by various state laws to pay a portion of the proceeds from the sale of cemetery property interment rights into perpetual care trust funds. The income earned from these perpetual care trusts offsets maintenance expenses for cemetery property and memorials. This trust fund income is recognized, as earned, in Revenues: Cemetery. Trust management fees charged by CSV RIA are included in revenue in the period in which they are earned. At September 30, 2016, none of our cemetery perpetual care trust investments were under-funded.

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, 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 municipal bonds, foreign debt, corporate debt, preferred stock, mortgage backed securities and fixed income mutual funds, all of which are classified within Level 2 of the valuation hierarchy. We review and update our fair value hierarchy classifications quarterly. There

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were no transfers between Levels 1 and 2 in the three and nine months ended September 30, 2016. There are no Level 3 investments in the cemetery perpetual care trust investment portfolio. See Note 9 to the Consolidated Financial Statements included herein for further information of the fair value measurement and the three-level valuation hierarchy.

The following table reflects the cost and fair market values associated with the trust investments held in perpetual care trust funds at September 30, 2016 (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$4,656	\$ —	\$ —	\$4,656
Fixed income securities:					
Municipal bonds	2	368	—	—	368
Foreign debt	2	5,772	175	(497 )	5,450
Corporate debt	2	15,927	1,099	(1,059 )	15,967
Preferred stock	2	11,465	18	(493 )	10,990
Mortgage backed securities	2	149	—	(10 )	139
Common stock	1	7,507	344	(1,950 )	5,901
Mutual funds:					
Fixed Income	2	867	90	—	957
Trust securities		\$46,711	\$ 1,726	\$ (4,009 )	\$44,428
Accrued investment income		\$620			\$620
Cemetery perpetual care investments					\$45,048
Market value as a percentage of cost					95.1 %

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

Due in one year or less	\$183
Due in one to five years	5,053
Due in five to ten years	4,145
Thereafter	23,533
	\$32,914

The following table reflects the cost and fair market values associated with the trust investments held in perpetual care trust funds at December 31, 2015 (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	\$5,472	\$ —	\$ —	\$5,472
Fixed income securities:					
Municipal bonds	2	325	—	(45 )	280
Foreign debt	2	3,232	—	(480 )	2,752
Corporate debt	2	16,216	57	(3,094 )	13,179
Preferred stock	2	11,263	20	(611 )	10,672
Common stock	1	11,945	393	(1,939 )	10,399
Trust securities		\$48,453	\$ 470	\$ (6,169 )	\$42,754
Accrued investment income		\$373			\$373
Cemetery perpetual care investments					\$43,127
Market value as a percentage of cost					88.2 %

We determine whether or not the assets in the cemetery perpetual care trusts have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis due to



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an other-than-temporary impairment is also recorded as a reduction to Care trusts' corpus. In the three months ended September 30, 2016, we recorded a \$0.1 million impairment for other-than-temporary declines in the fair value related to unrealized losses on certain investments. We did not record any impairments in the three months ended September 30, 2015. In the nine months ended September 30, 2015 and 2016, we recorded a \$0.5 million impairment for other-than-temporary declines in the fair value related to unrealized losses on certain investments. There is no impact on earnings until such time that the loss is realized in the trusts, allocated to preneed contracts and the services are performed or the merchandise is delivered causing the contract to be withdrawn from the trust in accordance with state regulations.

At September 30, 2016, we had certain investments within our perpetual care trust investments that had tax lots in loss positions for more than one year. Based on our analyses of these securities, the companies' businesses and current market conditions, we determined that these investment losses were temporary in nature.

Our perpetual care trust investment unrealized losses, their associated fair market values, and the duration of unrealized losses for the periods ended September 30, 2016 and December 31, 2015 are shown in the following tables (in thousands):

	September 30, 2016					
	In Loss Position Less than 12 months		In Loss Position Greater than 12 months		Total	
	Fair Market Value	Unrealized Losses	Fair Market Value	Unrealized Losses	Fair Market Value	Unrealized Losses
Fixed income securities:						
Foreign debt	1,632	(91 )	1,990	(406 )	3,622	(497 )
Corporate debt	4,948	(148 )	3,529	(911 )	8,477	(1,059 )
Preferred stock	1,126	(8 )	8,537	(485 )	9,663	(493 )
Mortgage backed securities	140	(10 )	—	—	140	(10 )
Common stock	2,932	(872 )	1,561	(1,078 )	4,493	(1,950 )
Total temporary impaired securities	\$10,778	\$(1,129 )	\$15,617	\$(2,880 )	\$26,395	\$(4,009 )

	December 31, 2015					
	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:						
Municipal bonds	\$280	\$(45 )	\$—	\$—	\$280	\$(45 )
Foreign debt	2,541	(265 )	281	(215 )	2,822	(480 )
Corporate debt	10,463	(2,164 )	2,210	(931 )	12,673	(3,095 )
Preferred stock	7,100	(301 )	3,568	(309 )	10,668	(610 )
Common stock	7,379	(1,220 )	2,186	(719 )	9,565	(1,939 )
Total temporary impaired securities	\$27,763	\$(3,995 )	\$8,245	\$(2,174 )	\$36,008	\$(6,169 )

Perpetual care trust investment security transactions recorded in Interest expense on our Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2016 were as follows (in thousands):

For the Three Months Ended September	For the Nine Months Ended September 30,
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	30,			
	2015	2016	2015	2016
Realized gains	\$731	\$44	\$1,706	\$156
Realized losses	(207 )	(261)	(692 )	(1,943)
Decrease (increase) in care trusts' corpus	(524 )	217	(1,014 )	1,787
Total	\$—	\$—	\$—	\$—

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Perpetual care trust investment security transactions recorded in Revenues: Cemetery for the three and nine months ended September 30, 2015 and 2016 were as follows (in thousands):

	For the Three Months Ended September 30, 2015		For the Nine Months Ended September 30, 2016	
Investment income	\$1,371	\$1,523	\$3,739	\$4,503
Realized gain, net	213	14	497	(444)
Total	\$1,584	\$1,537	\$4,236	\$4,059

Purchases and sales of investments in the perpetual care trusts were as follows (in thousands):

	For the Three Months Ended September 30, 2015		For the Nine Months Ended September 30, 2016	
Purchases	\$(7,247)	\$(936)	\$(15,352)	\$(12,888)
Sales	\$2,532	\$3,832	\$8,885	\$11,702

#### 9. FAIR VALUE MEASUREMENTS

We evaluate our financial assets and liabilities for those financial assets and liabilities that meet the criteria of the disclosure requirements and fair value framework. The carrying values of cash and cash equivalents, trade receivables and trade payables approximate the fair values of those instruments due to the short-term nature of the instruments. The fair values of receivables on preneed funeral and cemetery contracts are impracticable to estimate because of the lack of a trading market and the diverse number of individual contracts with varying terms. Our long-term debt and Credit Facility (as defined in Note 11) are classified within Level 2 of the Fair Value Measurement hierarchy. The fair values of our long-term debt and Credit Facility approximate the carrying values of these instruments based on the index yields of similar securities compared to U.S. Treasury yield curves. The fair value of the convertible subordinated notes due 2021 was approximately \$169.6 million at September 30, 2016 based on the last traded or broker quoted price. We identified investments in fixed income securities, common stock and mutual funds presented within the preneed and perpetual care trust investment categories on our Consolidated Balance Sheets as having met the criteria for fair value measurement. As of September 30, 2016, we did not have any assets that had fair values determined by Level 3 inputs and no liabilities measured at fair value.

We account for our investments as available-for-sale and measure them at fair value under the standards of financial accounting and reporting for investments in equity instruments that have readily determinable fair values and for all investments in debt securities. See Notes 5 and 8 to our Consolidated Financial Statements included herein for the fair value hierarchy levels of our trust investments.

#### 10. INTANGIBLE AND OTHER NON-CURRENT ASSETS

Intangibles and other non-current assets at December 31, 2015 and September 30, 2016 were as follows (in thousands):

	December 31, 2015	September 30, 2016
Prepaid agreements not-to-compete, net of accumulated amortization of \$5,404 and \$5,713, respectively	\$ 1,912	\$ 2,536
Tradenames	8,856	11,940
Other	210	—
Intangible and other non-current assets	\$ 10,978	\$ 14,476

Prepaid agreements not-to-compete are amortized over the term of the respective agreements, ranging generally from one to ten years. Amortization expense was approximately \$76,000 and \$106,000 for the three months ended September 30, 2015 and 2016, respectively, and \$223,000 and \$308,000 for the nine months ended September 30, 2015 and 2016, respectively.

During the nine months ended September 30, 2016, we increased prepaid agreements not-to-compete by \$0.8 million related to our acquisition of two funeral home businesses in May 2016 and our acquisition of one funeral home business in September 2016 described in Note 3 to the Consolidated Financial Statements included herein.

Our tradenames have indefinite lives and therefore are not amortized. During the three months ended September 30, 2016, we recorded an impairment to tradenames of \$145,000 related to a funeral home business held for sale at September 30, 2016, as the carrying value exceeded its fair value. The impairment was recorded in Other income (expense) on our Consolidated Sta

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tements of Operations. See Note 1 to the Consolidated Financial Statements included herein, for a discussion of the methodology used for our annual indefinite-lived intangible asset impairment test.

During the nine months ended September 30, 2016, we increased tradenames by approximately \$3.2 million related to our acquisition of two funeral home businesses in May 2016 described in Note 3 to the Consolidated Financial Statements included herein.

**11.LONG-TERM DEBT**

Our long-term debt consisted of the following at December 31, 2015 and September 30, 2016 (in thousands):

	December 31, 2015	September 30, 2016
Revolving credit facility, secured, floating rate	\$92,600	\$63,300
Term loan, secured, floating rate	110,937	141,563
Acquisition debt	4,929	7,573
Debt issuance costs, net of accumulated amortization of \$3,246 and \$4,062, respectively	(1,445 )	(1,346 )
Less: current portion	(12,012 )	(12,389 )
Total long-term debt	\$195,009	\$198,701

As of September 30, 2016, we had a \$300 million secured bank credit facility with Bank of America, N.A. as Administrative Agent (the "Credit Agreement"), comprised of a \$150 million revolving credit facility and a \$150 million term loan (collectively, the "Credit Facility"). The Credit Facility also contains an accordion provision to borrow up to an additional \$75 million in revolving loans, subject to certain conditions. The Credit Facility is collateralized by all personal property and funeral home real property in certain states.

On February 9, 2016, we entered into a seventh amendment (the "Seventh Amendment") to our Credit Facility. The Seventh Amendment resulted in, among other things, (i) reducing our LIBOR based variable interest rate 37.5 basis points, (ii) extending the maturity so that the Credit Agreement will mature at the earlier of (a) any date that is 91 days prior to the maturity of any subordinated debt (including the \$143.75 million in principal amount of the Convertible Notes, as defined in Note 12 to the Consolidated Financial Statements included herein) or (b) February 9, 2021, (iii) increasing and funding the term loan so that \$150 million was outstanding upon the effectiveness of the Seventh Amendment, (iv) reducing the size of the revolver to \$150 million, (v) increasing the accordion to \$75 million and (vi) updating the amortization payments for the term loan facility so that the borrowings under the term loan facility are subject to amortization payments of (a) \$2.81 million at the end of each fiscal quarter beginning with the fiscal quarter ending March 31, 2016 through the fiscal quarter ending December 31, 2017, (b) \$3.75 million at the end of each fiscal quarter beginning with the fiscal quarter ending March 31, 2018 through the fiscal quarter ending March 31, 2020 and (c) \$4.69 million at the end of each fiscal quarter beginning with the fiscal quarter ending June 30, 2020 through the fiscal quarter ending December 31, 2020. In connection with the Seventh Amendment, we recognized a loss of \$0.6 million to write-off the related unamortized debt issuance costs.

As of September 30, 2016, we had outstanding borrowings under the revolving credit facility of \$63.3 million and approximately \$141.6 million was outstanding on the term loan. No letters of credit were issued and outstanding under the Credit Facility at September 30, 2016. Outstanding borrowings under the Credit Facility bear interest at either a prime rate or a LIBOR rate, plus an applicable margin based upon our leverage ratio. As of September 30, 2016, the prime rate margin was equivalent to 1.125% and the LIBOR margin was 2.125%. The weighted average interest rate on the Credit Facility for both the three and nine months ended September 30, 2016 was 2.8%.

We were in compliance with the covenants contained in the Credit Agreement as of September 30, 2016. The Credit Agreement contains key ratios that we must comply with including a requirement to maintain a leverage ratio of no more than 3.5 to 1.00 and a covenant to maintain a fixed charge coverage ratio of no less than 1.20 to 1.00. As of September 30, 2016, the leverage ratio was 2.96 to 1.00 and the fixed charge coverage ratio was 2.40 to 1.00.

Beginning January 1, 2016, debt issuance costs are retroactively reflected as a direct deduction from the carrying value of the related debt liability (refer herein to Note 1 to the Consolidated Financial Statements). Amortization of debt issuance costs related to our Credit Facility was approximately \$0.1 million for both the three months ended September 30, 2015 and 2016 and \$0.4 million and \$0.3 million for the nine months ended September 30, 2015 and 2016, respectively. Debt issuance costs are being amortized over the term of the related debt using the effective

interest method for our term loan and the straight line method for our revolving credit facility.

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Acquisition debt consists of deferred purchase price and promissory notes payable to sellers. The increase in acquisition debt was primarily related to the \$3.5 million of deferred purchase price payments for the two funeral home businesses acquired in May 2016.

**12.CONVERTIBLE SUBORDINATED NOTES**

On March 19, 2014, we issued \$143.75 million aggregate principal amount of 2.75% convertible subordinated notes due March 15, 2021 (the "Convertible Notes"). The Convertible Notes bear interest at 2.75% per year. Interest on the Convertible Notes began to accrue on March 19, 2014 and is payable semi-annually in arrears on March 15 and September 15 of each year.

The carrying values of the liability and equity components of the Convertible Notes at December 31, 2015 and September 30, 2016 are reflected in our Consolidated Balance Sheets as follows (in thousands):

	December 31, 2015	September 30, 2016
Long-term liabilities:		
Principal amount	\$143,750	\$143,750
Unamortized discount of liability component	(25,754 )	(22,895 )
Convertible Notes issuance costs, net of accumulated amortization of \$858 and \$1,233 respectively	\$(2,769 )	\$(2,394 )
Carrying value of the liability component	\$115,227	\$118,461

Equity component carrying value	\$17,973	\$17,973
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The fair value of the Convertible Notes, which are Level 2 measurements, was approximately \$169.6 million at September 30, 2016.

Interest expense on the Convertible Notes included contractual coupon interest expense of approximately \$1.0 million for both the three months ended September 30, 2015 and 2016 and \$3.0 million for both the nine months ended September 30, 2015 and 2016, respectively. Amortization of debt issuance costs related to our Convertible Notes was approximately \$0.1 million for both the three months ended September 30, 2015 and 2016 and \$0.4 million for both the nine months ended September 30, 2015 and 2016, respectively. Accretion of the discount on the Convertible Notes was \$0.9 million and \$1.0 million for the three months ended September 30, 2015 and 2016, respectively, and \$2.6 million and \$2.9 million for the nine months ended September 30, 2015 and 2016, respectively.

During the three months ended September 30, 2016, an adjustment to the conversion rate of the Convertible Notes was triggered when our Board increased the dividends declared per common share from \$0.025 per share to \$0.05 per share. The initial conversion rate of the Convertible Notes was 44.3169 shares of our common stock per \$1,000 principal amount of Convertible Notes, equivalent to an initial conversion price of approximately \$22.56 per share of common stock. The adjusted conversion rate of the Convertible Notes is 44.3639 shares of our common stock per \$1,000 principal amount of Convertible Notes, equivalent to an adjusted conversion price of approximately \$22.54 per share of common stock.

Beginning January 1, 2016, debt issuance costs are retroactively reflected as a direct deduction from the carrying value of the related debt liability (refer herein to Note 1 to the Consolidated Financial Statements). The unamortized discount and the unamortized debt issuance costs are being amortized using the effective interest method over the remaining term of the Convertible Notes. The effective interest rate on the unamortized discount and the debt issuance costs for the three and nine months ended September 30, 2015 and 2016 was 6.75% and 2.75%, respectively.

**13.STOCKHOLDERS' EQUITY****Stock Options**

As of September 30, 2016, there were 1,716,655 stock options outstanding and 548,800 stock options which remain unvested. We did not grant any stock options in the three months ended September 30, 2016. During the first quarter of 2016, we granted 235,500 options to certain officers and key employees at an option price of \$20.06. These options will vest in one-fifth increments over a five-year period and have a ten-year term. The fair value of the total options granted during the first quarter of 2016 was approximately \$1.3 million. During the three months ended September 30, 2016, we canceled 146,100 options related to the retirement of a former executive. We recorded pre-tax stock-based

compensation expense for stock options totaling approximately \$0.6 million and \$0.2 million for the three months ended September 30, 2015 and 2016, respectively, and \$1.8 million and \$1.4 million for the nine months ended September 30, 2015 and 2016, respectively.

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## Performance Awards

During the first quarter of 2016, we granted 73,700 performance awards to certain officers and key employees, payable in shares. We did not grant any performance awards in the three months ended September 30, 2016. These awards will vest (if at all) on December 31, 2020 provided that certain criteria surrounding Adjusted Consolidated EBITDA (Adjusted Consolidated Earnings Before Interest Tax Depreciation and Amortization) and Relative Shareholder Return performance is achieved and the individual has remained continuously employed by the Company through such date. The Adjusted Consolidated EBITDA performance represents 25% of the award and the Relative Shareholder Return performance represents 75% of the award. The fair value of these performance awards granted during the first quarter of 2016 was approximately \$1.6 million. During the three months ended September 30, 2016, we canceled 14,200 performance awards related to the retirement of a former executive. The pre-tax compensation expense associated with the performance awards was approximately \$46,000 for the three months ended September 30, 2016 and \$154,000 for the nine months ended September 30, 2016.

## Restricted Stock Grants

We did not issue any restricted stock during the three months ended September 30, 2016. During the first quarter of 2016, we issued a total of 16,900 restricted stock grants that vest over a three-year period with an aggregate grant date market value of approximately \$0.3 million.

During the three months ended September 30, 2015 and 2016, we recorded \$366,000 of pre-tax compensation expense and a benefit of \$21,000, respectively, related to the vesting of restricted stock awards, which is included in general, administrative and other expenses. The benefit was primarily related to the cancellation of 50,000 unvested restricted stock for a former executive. During the nine months ended September 30, 2015 and 2016, we recorded pre-tax compensation expense of approximately \$1.2 million and \$0.5 million, respectively.

As of September 30, 2016, we had approximately \$1.3 million of total unrecognized compensation costs related to unvested restricted stock awards, which are expected to be recognized over a weighted average period of approximately 1.7 years.

## Employee Stock Purchase Plan

During the third quarter of 2016, employees purchased a total of 11,485 shares of common stock through the employee stock purchase plan ("ESPP") at a weighted average price of \$19.92 per share. We recorded pre-tax stock-based compensation expense for the ESPP totaling approximately \$36,000 and \$53,000 for the three months ended September 30, 2015 and 2016, respectively, and \$165,000 and \$197,000 for the nine months ended September 30, 2015 and 2016, respectively.

The fair value of the option to purchase shares under the ESPP is estimated on the date of grant (January 1 of each year) associated with the four quarterly purchase dates using the following assumptions:

	2016	
Dividend yield	0.6	%
Expected volatility	24.71	%
Risk-free interest rate	0.22%, 0.49%, 0.55%, 0.61%	
Expected life (years)	0.25, 0.50, 0.75, 1.00	

Expected volatilities are based on the historical volatility during the previous twelve months of the underlying common stock. The risk-free rate for the quarterly purchase periods is based on the U.S. Treasury yields in effect at the time of the purchase. The expected life of the ESPP grants represents the calendar quarters from the beginning of the year to the purchase date (end of each quarter).

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Director Compensation Policy

On May 17, 2016, our Board of Directors (our “Board”) approved a new Director Compensation Policy, which provides for the following: (i) each independent director is entitled to an annual retainer of \$75,000, payable in quarterly installments of \$18,750 each at the end of the quarter; and (ii) the Lead Director and chairman of our Audit Committee are entitled to an additional annual retainer of \$10,000, payable in quarterly installments of \$2,500 each at the end of each quarter, and the chairman of our Corporate Governance and Compensation Committees are entitled to an additional annual retainer of \$5,000, payable in quarterly installments of \$1,250 each at the end of each quarter. Any new independent director will receive upon admission to the Board a grant of \$25,000 (in addition to the independent director annual retainer prorated at the time the new director is admitted to the Board) which can be taken in cash or restricted shares of our common stock. The number of shares of such common stock will be determined by dividing the cash amount by the closing price of our common stock on the date of grant, which will be the date of admission to the Board. Such common stock, will vest (based on continued service on the Board) 50% immediately and 25% on the first and second anniversaries of admission. Prior to the approval of the new Director Compensation Policy, there was one meeting during the second quarter of 2016 for which the directors were paid under the previous policy.

On August 9, 2016, Richard W. Scott resigned from our Board. At the time of his resignation, Mr. Scott was currently serving as the chairman of the Corporate Governance Committee and a member of the Audit and Compensation Committees. On the same day, the Board voted James R. Schenck to serve as a Class 1 Director until the 2018 annual meeting of shareholders. Mr. Schenck was appointed to serve as the chairman of the Corporate Governance Committee and a member of the Audit and Compensation Committees. Concurrently with the appointment, the Board granted Mr. Schenck 1,061 shares of the Company’s common stock under our Director Compensation Policy, which such grant was valued at approximately \$25,000 based on the closing price on the grant date. One-half of these shares vested immediately upon grant, and the remaining one-half of the shares will vest equally on August 9, 2017 and August 9, 2018.

We recorded approximately \$148,000 and \$90,000 of pre-tax compensation expense, which is included in general, administrative and other expenses, for the three months ended September 30, 2015 and 2016, respectively, and \$554,000 and \$302,000 for the nine months ended September 30, 2015 and 2016, respectively, related to the director fees and annual retainers.

Share Repurchase Program

On February 25, 2016, our Board approved a share repurchase program authorizing us to purchase up to an aggregate of \$25.0 million of our common stock in accordance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). The shares may be purchased from time to time in the open market or in privately negotiated transactions. Purchases will be at times and in amounts as management deems appropriate based on factors such as market conditions, legal requirements and other business considerations. During the three and nine months ended September 30, 2016, we did not repurchase any shares of common stock.

Cash Dividends

On May 19, 2016, our Board approved an increase in our quarterly dividend on our common stock from \$0.025 to \$0.050 per share, effective with respect to dividends payable on September 1, 2016 and later. On August 1, 2016 our Board declared a dividend of \$0.050 per share, totaling approximately \$0.8 million, which was paid on September 1, 2016 to record holders of our common stock as of August 16, 2016. For the nine months ended September 30, 2015 and 2016, we paid total dividends of approximately \$1.4 million and \$1.7 million, respectively. We have a dividend reinvestment program so that stockholders may elect to reinvest their dividends into additional shares of our common stock.

Accumulated other comprehensive income

Our components of accumulated other comprehensive income are as follows:

Accumulated  
Other  
Comprehensive  
Income

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Balance at December 31, 2015	\$	—
Decrease in net unrealized gains associated with available-for-sale securities of the trusts	(8,999	)
Reclassification of net unrealized gain activity attributable to the Deferred preneed funeral and cemetery receipts held in trust and Care trusts' corpus	8,999	
Balance at September 30, 2016	\$	—

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## 14.EARNINGS PER SHARE

The following table sets forth the computation of the basic and diluted earnings per share for the three and nine months ended September 30, 2015 and 2016 (in thousands, except per share data):

	For the Three Months Ended September 30, 2015		For the Nine Months Ended September 30, 2016	
Numerator for basic and diluted earnings per share:				
Net income	\$4,444	\$5,683	\$15,419	\$15,454
Less: Earnings allocated to unvested restricted stock	(51 )	(25 )	(194 )	(76 )
Income attributable to common stockholders	\$4,393	\$5,658	\$15,225	\$15,378
Denominator:				
Denominator for basic earnings per common share - weighted average shares outstanding	17,874	16,529	18,115	16,502
Effect of dilutive securities:				
Stock options	209	273	240	260
Convertible subordinated notes	—	299	233	200
Denominator for diluted earnings per common share - weighted average shares outstanding	18,083	17,101	18,588	16,962
Basic earnings per common share:	\$0.24	\$0.34	\$0.84	\$0.93
Diluted earnings per common share:	\$0.24	\$0.33	\$0.82	\$0.91

The fully diluted weighted average shares outstanding for the three and nine months ended September 30, 2016 and the corresponding calculation of fully diluted earnings per share, include approximately 299,000 and 200,000 shares that would have been issued upon the conversion of our convertible subordinated notes as a result of the application of the if-converted method prescribed by the FASB ASC 260, respectively. There were no shares for the three months ended September 30, 2015 and 233,000 shares for the nine months ended September 30, 2015 that would have been issued upon conversion under the if-converted method.

For the three and nine months ended September 30, 2016, no stock options were excluded from the computation of diluted earnings per share because the inclusion of such stock options would result in an antidilutive effect. For the three and nine months ended September 30, 2015, 584,000 stock options were excluded from the computation of diluted earnings per share because the inclusion of such stock options would result in an antidilutive effect.

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## 15.MAJOR SEGMENTS OF BUSINESS

We conduct funeral and cemetery operations only in the United States. The following table presents revenue from operations, pre-tax income (loss) from operations and total assets by segment (in thousands):

	Funeral	Cemetery	Corporate	Consolidated
Revenues from operations:				
Three months ended September 30, 2016	\$45,183	\$14,957	\$—	\$ 60,140
Three months ended September 30, 2015	\$44,089	\$14,289	\$—	\$ 58,378
Nine months ended September 30, 2016	\$140,952	\$44,384	\$—	\$ 185,336
Nine months ended September 30, 2015	\$138,727	\$42,165	\$—	\$ 180,892
Income (loss) from operations before income taxes:				
Three months ended September 30, 2016	\$13,478	\$4,327	\$(10,231)	\$ 7,574
Three months ended September 30, 2015	\$12,593	\$4,312	\$(9,654)	\$ 7,251
Nine months ended September 30, 2016	\$44,322	\$12,875	\$(33,337)	\$ 23,860
Nine months ended September 30, 2015	\$43,792	\$12,814	\$(30,672)	\$ 25,934
Total assets:				
September 30, 2016	\$616,588	\$235,420	\$7,503	\$ 859,511
December 31, 2015	\$591,389	\$229,479	\$12,271	\$ 833,139

## 16.SUPPLEMENTARY DATA

## Balance Sheet

The detail of certain balance sheet accounts as of December 31, 2015 and September 30, 2016:

	December 31, 2015	September 30, 2016
Other Current Assets:		
Deferred taxes	\$ 4,256	\$ —
Income taxes receivable	279	734
Other current assets	172	104
Total other current assets	\$ 4,707	\$ 838
Other Liabilities:		
Income taxes payable	\$ 387	\$ 2,343
Deferred rent	137	200
Other liabilities	—	3
Other current liabilities	\$ 524	\$ 2,546
Other Long Term Liabilities:		
Deferred rent	\$ 1,405	\$ 1,261
Incentive compensation	2,505	605
Reserve for uncertain tax positions	814	—
Contingent consideration	763	763
Other long term liabilities	44	—
Total other long term liabilities	\$ 5,531	\$ 2,629



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17.SUBSEQUENT EVENTS

On October 20, 2016, we sold a funeral home business in Tennessee for approximately \$1.35 million in cash and certain real estate in Georgia for approximately \$0.6 million in cash.

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CAUTIONARY STATEMENT ON FORWARD-LOOKING STATEMENTS

In addition to historical information, this Form 10-Q contains certain statements and information that may constitute forward-looking statements within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements include statements regarding any projections of earnings, revenues, asset sales, cash flow, debt levels or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements regarding future economic conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing and are based on our current expectations and beliefs concerning future developments and their potential effect on us. The words “may”, “will”, “estimate”, “intend”, “believe”, “expect”, “seek”, “project”, “forecast”, “foresee”, “should”, “would”, “could”, “plan”, “anticipate” and other similar words or phrases are intended to identify forward-looking statements, which are generally not historical in nature. While management believes that these forward-looking statements are reasonable as and when made, there can be no assurance that future developments affecting us will be those that we anticipate. All comments concerning our expectations for future revenues and operating results are based on our forecasts for our existing operations and do not include the potential impact of any future acquisitions. Our forward-looking statements involve significant risks and uncertainties (some of which are beyond our control) and assumptions that could cause actual results to differ materially from our historical experience and our present expectations or projections. Important factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to, those summarized below:

- the ability to find and retain skilled personnel;
- the effects of competition;
- the execution of our Standards Operating, 4E Leadership and Strategic Acquisition Models;
- changes in the number of deaths in our markets;
- changes in consumer preferences;
- our ability to generate preneed sales;
- the investment performance of our funeral and cemetery trust funds;
- fluctuations in interest rates;
- our ability to obtain debt or equity financing on satisfactory terms to fund additional acquisitions, expansion projects, working capital requirements and the repayment or refinancing of indebtedness;
- death benefits related to preneed funeral contracts funded through life insurance contracts;
- the financial condition of third-party insurance companies that fund our preneed funeral contracts;
- increased or unanticipated costs, such as insurance or taxes;
- effects of the application of applicable laws and regulations, including changes in such regulations or the interpretation thereof;
- consolidation of the deathcare industry; and
- other factors and uncertainties inherent in the deathcare industry.

For additional information regarding known material factors that could cause our actual results to differ from our projected results, please see (i) Part II, Item 1A “Risk Factors” in this Form 10-Q and (ii) Part I, Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statements after the date they are made, whether as a result of new information, future events or otherwise.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

General

We operate in two business segments: funeral home operations, which currently account for approximately 76% of our revenues, and cemetery operations, which account for approximately 24% of our revenues. 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 that sell interment rights (grave sites and mausoleum spaces) and related merchandise, such as markers and outer burial containers. We compete with other public deathcare companies and smaller, independent operators and believe we are a market leader (first or second) in most of our markets. We provide funeral and cemetery services and products on both an “at-need” (time of death) and “preneed” (planned prior to death) basis. At September 30, 2016, we operated 169 funeral homes in 27 states and 32 cemeteries in 11 states within the United States.

Our business strategy is based on strong, local leadership and entrepreneurial principles that we believe drive market share, revenue growth, and profitability in our local markets. We strive to have the most innovative and transparent operating and reporting framework in the deathcare industry. We are able to achieve such an innovative and transparent framework through a decentralized, high-performance cultural operating framework with linked incentive compensation programs that attract top-quality industry talent at all levels.

We are defined by our Mission Statement which states that “we are committed to being the most professional, ethical and highest quality funeral and cemetery service organization in our industry” and our Guiding Principles which state our core values that are comprised of:

honesty, integrity and quality in all that we do;

hard work, pride of accomplishment and shared success through employee ownership;

belief in the power of people through individual initiative and teamwork;

outstanding service and profitability go hand-in-hand; and

growth of the Company is driven by decentralization and partnership.

Our five Guiding Principles collectively embody our “Being The Best” high-performance cultural, operating framework.

Our general operations and business strategy are built upon the execution of the following three models:

Standards Operating Model;

4E Leadership Model; and

Strategic Acquisition Model.

Standards Operating Model

Our Standards Operating Model (our “Standards”) eliminates the use of financial budgets which creates enormous amounts of time to focus and work on growing each local business and improving the quality and skills of the staff. Instead of the budget and control model, our Standards, which we refer to as “Being The Best,” focus on market share, people, and operating and financial metrics that drive long-term, sustainable revenue growth and earning power of our portfolio of businesses by employing leadership and entrepreneurial principles that fit the nature of our local, personal service, high-value business. Standards Achievement is the measure by which we judge the success of each business and incentivize the local managers. Our Standards are not designed to produce maximum short-term earnings because we do not believe such performance is sustainable and will ultimately stress the business, which very often leads to declining market share, revenues and earnings.

4E Leadership Model

Our 4E Leadership Model requires strong local leadership in each business to grow an entrepreneurial, decentralized, high-value, personal service and sales business at sustainable profit margins. Our 4E Leadership Model is based upon principles established by Jack Welch during his tenure at General Electric, and is based upon 4E qualities essential to succeed in a high-performance culture: Energy to get the job done; the ability to Energize others; the Edge necessary to make difficult decisions; and the ability to Execute and produce results. To achieve a high level within our Standards in a business year after year, we require “A Players” in charge that have the 4E Leadership skills to entrepreneurially grow the business by hiring, training and developing highly motivated and productive teams locally that produce results.



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### Strategic Acquisition Model

Our Standards Operating Model led to the development of our “Strategic Acquisition Model”, which guides our acquisition strategy. Both models, when executed effectively, will drive long-term, sustainable increases in market share, revenue and earnings. We believe a primary driver of higher revenue and profits in the future will be the execution of our Strategic Acquisition Model using strategic ranking criteria to assess acquisition and divestiture candidates. As we execute this strategy over time, we will acquire larger, higher margin strategic businesses and divest smaller businesses in non-strategic markets.

Our belief in our Mission Statement and Guiding Principles that define us and proper execution of the three models that define our strategy have given us the competitive advantage in any market in which we compete. We believe that we can execute our three models without proportionate incremental investment in our consolidation platform infrastructure or additional fixed regional and corporate overhead. This competitive advantage is evidenced by the sustained earning power of our portfolio as defined by our EBITDA margin. Our deep understanding of each market landscape and our historical, successful competition in individual local markets more than reasonably ensures that we are promoting the interests of the consumer and supporting unfettered markets which, in turn, results in better pricing and more choices for the consumer.

### CURRENT PERIOD DEVELOPMENTS

**Acquisitions.** On September 20, 2016, we acquired one funeral home business in Madera, California. The pro forma impact of the acquisition on prior periods is not presented, as the impact is not material to our reported results.

**Board Of Directors.** On August 9, 2016, Richard W. Scott resigned from the Board of Directors (Board). At the time of his resignation, Mr. Scott was currently serving as the chairman of the Corporate Governance Committee and a member of the Audit and Compensation Committees. On the same day, the Board voted James R. Schenck to serve as a Class 1 Director until the 2018 annual meeting of shareholders.

**Executive Leadership Changes.** David J. DeCarlo resigned as President of the Company and Vice Chairman of the Board due to his retirement, effective September 30, 2016. As a result, the total size of the Board decreased from six to five members.

### REPORTING AND NON-GAAP FINANCIAL MEASURES

We also present our financial performance in our “Operating and Financial Trend Report” (“Trend Report”) as reported in our earnings release for the quarter ending September 30, 2016 dated October 25, 2016 and discussed in the corresponding earnings conference call. This Trend Report is used as a supplemental financial measurement statement by management and investors to compare our current financial performance with our previous results and with the performance of other companies. We do not intend for this information to be considered in isolation or as a substitute for other measures of performance prepared in accordance with United States generally accepted accounting principles (“GAAP”). The Trend Report is a non-GAAP statement that also provides insight into underlying trends in our business. Historically, the dynamic nature of the evolutionary process of building our culture, especially since launching the Good To Great Journey in the beginning of 2012, has led to a large number of charges such as severance and retirement, consulting and other activities, which are not core to our operations and as such, have been added back to GAAP earnings as “Special Items”. The Special Items are important to add back because of the transformational nature of major changes over the last several years within our Operations and Strategic Growth Leadership Team, culminating during 2015 in a reduction from fifteen members to nine members and most recently to eight members due to the retirement of David J. DeCarlo, effective September 30, 2016. The number of these Special Items should be minimal during 2016 and thereafter.

Accordingly, beginning in the first quarter of 2016, these non-GAAP Special Items will be comprised of only those charges materially outside the normal course of business, which should result in major shrinkage of “the gap” between our GAAP and non-GAAP reported performance.

The non-GAAP financial measures in the Trend Report include such measures as “Special Items,” “Adjusted Net Income,” “Consolidated EBITDA,” “Adjusted Consolidated EBITDA,” “Adjusted Consolidated EBITDA Margin,” “Adjusted Free Cash Flow,” “Funeral, Cemetery and Financial EBITDA,” “Total Field EBITDA,” “Total Field EBITDA Margin,” “Adjusted Basic Earnings Per Share” and “Adjusted Diluted Earnings Per Share”. These financial measurements are defined as GAAP items adjusted for Special Items and are reconciled to GAAP in our earnings release and on the Trend Reports

posted on our website ([www.carriageservices.com](http://www.carriageservices.com)). In addition, our presentation of these measures may not be comparable to similarly titled measures in other companies' reports.

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The non-GAAP definitions used by the Company are as follows:

Special Items are defined as charges or credits included in our GAAP financial statements that can vary from period to period and are not reflective of costs incurred in the ordinary course of our operations. Special Items are taxed at the federal statutory rate of 34 percent for the three and nine months ended September 30, 2015 and 35 percent for the three and nine months ended September 30, 2016, except for the accretion of the discount on the Convertible Notes as this is a non-tax deductible item and the tax adjustment from prior period.

Adjusted Net Income is defined as net income plus adjustments for Special Items.

Consolidated EBITDA is defined as net income before income taxes, interest expenses, non-cash stock compensation, depreciation and amortization, and interest income and other, net.

Adjusted Consolidated EBITDA is defined as Consolidated EBITDA plus adjustments for Special Items.

Adjusted Consolidated EBITDA Margin is defined as Adjusted Consolidated EBITDA as a percentage of revenue.

Adjusted Free Cash Flow is defined as net cash provided by operations, adjusted by cash-related Special Items, less cash for maintenance capital expenditures.

Funeral Field EBITDA is defined as Funeral Gross Profit, which is funeral revenue minus funeral field costs and expenses, less depreciation and amortization, regional and unallocated funeral overhead expenses and Funeral Financial EBITDA.

Cemetery Field EBITDA is defined as Cemetery Gross Profit, which is cemetery revenue minus cemetery field costs and expenses, less depreciation and amortization, regional and unallocated cemetery overhead expenses and Cemetery Financial EBITDA.

Funeral Financial EBITDA is defined as Funeral Financial Revenue less Funeral Financial Expenses.

Cemetery Financial EBITDA is defined as Cemetery Financial Revenue less Cemetery Financial Expenses.

Total Field EBITDA is defined as Gross Profit less depreciation and amortization, regional and unallocated overhead expenses.

Total Field EBITDA Margin is defined as Total Field EBITDA as a percentage of revenue.

Adjusted Basic Earnings Per Share is defined as GAAP Basic Earnings Per Share, adjusted for Special Items.

Adjusted Diluted Earnings Per Share is defined as GAAP Diluted Earnings Per Share, adjusted for Special Items.

The non-GAAP Withdrawable Trust Income in our Trend Reports reflects the change in the available income we are able to withdraw from Preneed Cemetery Trusts in three states that allow cash income to be withdrawn prior to maturity of the contract. The intent of this presentation was to show the true cash earning power of our Company.

However, the amount of reported Withdrawable Trust Income has been steadily declining over the past years while our Adjusted Consolidated EBITDA and Adjusted Consolidated EBITDA Margin have been materially increasing. As its financial impact is diminishing and the intrinsic value of reporting such non-GAAP affect is insignificant, we will no longer reflect Withdrawable Trust Income within the Special Items section of our Trend Reports.

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We are providing below a reconciliation of Net Income (a GAAP measure) to Adjusted Net Income (a non-GAAP measure) for the three and nine months ended September 30, 2016 compared to the three and nine months ended September 30, 2015.

	For the Three Months Ended September 30, 2015		For the Nine Months Ended September 30, 2016	
(In millions)				
Net Income	\$4.4	\$5.7	\$15.4	\$15.4
Special items, net of tax except for **				
Withdrawable Trust Income	0.1	n/a	0.4	n/a
Acquisition and Divestiture Expenses	—	—	0.4	0.3
Severance and Retirement Costs	0.1	0.8	0.5	2.6
Consulting Fees	0.4	—	0.9	0.3
Accretion of Discount on Convertible Subordinated Notes **	0.9	1.0	2.6	2.9
Costs Related to the Credit Facility	—	—	—	0.4
Gain on Sale of Asset	—	—	—	(0.2 )
Other Special Items	0.2	—	0.2	—
Tax Adjustment from Prior Period **	—	—	0.1	—
Adjusted Net Income	\$6.1	\$7.5	\$20.5	\$21.7

**Financial Highlights**

Three months ended September 30, 2016 compared to three months ended September 30, 2015

Total revenue for the three months ended September 30, 2016 and 2015 was \$60.1 million and \$58.4 million, respectively, which represents an increase of approximately \$1.8 million, or 3.0%. For the quarter comparatives, we experienced a 4.8% increase in total funeral contracts and a decrease in the average revenue per funeral contract of 2.2%. In addition, while we experienced a decrease of 8.2% in the number of preneed interment rights (property) sold, the average price per interment right sold increased 4.7%. Further discussion of revenue for our funeral home and cemetery segments as well as the contract mix is presented herein under “Results of Operations.”

Operating income increased \$1.0 million, or 9.7%, due primarily to better cost management in our same store funeral home operations, increases in funeral acquisition revenues as well as increases in sales and related revenue in our cemetery operations. Further discussion of operating income is presented herein under “Results of Operations” within our funeral home and cemetery segments.

Net income for the three months ended September 30, 2016 increased \$1.2 million to \$5.7 million, equal to \$0.33 per diluted share, compared to net income of \$4.4 million, equal to \$0.24 per diluted share, for the three months ended September 30, 2015. Further discussion of depreciation and amortization expense, general and administrative costs, interest expense, income taxes and other components of income and expenses are presented herein under “Other Financial Statement Items.”

Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

Total revenue for the nine months ended September 30, 2016 and 2015 was \$185.3 million and \$180.9 million, respectively, which represents an increase of \$4.4 million, or 2.5%. Year to date, we experienced a 1.4% increase in total funeral contracts and our average revenue per contract increased by 0.2%. In addition, while we experienced a decrease of 3.6% in the number of preneed interment rights (property) sold, the average price per interment right sold increased 6.7%. Further discussion of revenue for our funeral home and cemetery segments as well as the contract mix is presented herein under “Results of Operations.”

Operating income decreased \$0.2 million, or 0.6%, despite increasing revenues due primarily to increases in general and administrative expenses, depreciation and amortization and cemetery operating expenses. Further discussion of operating income is presented herein under “Results of Operations” within our funeral home and cemetery segments. Net income for the nine months ended September 30, 2016 remained flat at \$15.4 million, equal to \$0.91 per diluted share, compared to \$0.82 per diluted share, for the nine months ended September 30, 2015. The increase in earnings per diluted share is primarily due to the decrease in the number of shares outstanding for the nine months ended September 30, 2016, as a result of our share repurchase program in 2015. Further discussion depreciation and amortization expense, general and administrative costs, interest expense, income taxes and other components of income and expenses are presented herein under “Other Financial Statement Items.”

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## OVERVIEW OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of the Consolidated Financial Statements requires us to make estimates and judgments that affect the amounts reported in the unaudited consolidated financial statements and accompanying notes. 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 because there can be no assurance the margins, operating income and net earnings, as a percentage of revenues, will be consistent from year to year.

Management's discussion and analysis of financial condition and results of operations ("MD&A") is based upon our Consolidated Financial Statements presented herewith, which have been prepared in accordance with GAAP. Our critical accounting policies are discussed in MD&A in our Annual Report on Form 10-K for the year ended December 31, 2015.

## RESULTS OF OPERATIONS

The following is a discussion of our results of operations for the three and nine months ended September 30, 2016 compared to same periods of 2015. The term "same store" refers to funeral homes and cemeteries acquired prior to January 1, 2012 and operated for the entirety of each period being presented. Funeral homes and cemeteries purchased after December 31, 2011 are referred to as "acquired." This classification of acquisitions has been important to management and investors in monitoring the results of these businesses and to gauge the leveraging performance contribution that a selective acquisition program can have on total company performance. Depreciation and amortization, within our field costs and expenses and regional and unallocated funeral and cemetery costs are not included in operating profit, a non-GAAP financial measure. Adding back these items will result in Gross Profit, a GAAP financial measure.

Funeral Home Segment. The following tables set forth certain information regarding the revenues and operating profit from our funeral home operations for the three months ended September 30, 2016 compared to three months ended September 30, 2015 (dollars in thousands):

	For the Three		Change	
	Months Ended September 30, 2015	2016	Amount	%
<b>Revenues:</b>				
Same store operating revenue	\$33,617	\$33,356	\$(261 )	(0.8 )%
Acquired operating revenue	8,214	9,734	1,520	18.5 %
Preneed funeral insurance commissions	346	361	15	4.3 %
Preneed funeral trust earnings	1,912	1,732	(180 )	(9.4 )%
Total	\$44,089	\$45,183	\$1,094	2.5 %
<b>Operating profit:</b>				
Same store operating profit	\$12,108	\$12,403	\$295	2.4 %
Acquired operating profit	3,201	3,922	721	22.5 %
Preneed funeral insurance commissions	92	166	74	80.4 %
Preneed funeral trust earnings	1,890	1,710	(180 )	(9.5 )%
Total	\$17,291	\$18,201	\$910	5.3 %

Funeral home same store operating revenues for the three months ended September 30, 2016 decreased \$0.3 million, or 0.8%, when compared to the three months ended September 30, 2015. The decrease was due primarily to a 1.5% decrease in the average revenue per contract to \$5,241, while we experienced a 0.7% increase in same store contract volumes to 6,364. The average revenue per contract excludes the impact of the preneed funeral trust earnings (separately reflected in Revenues above) recognized at the time that we provide the services pursuant to the preneed contract. Including preneed funeral trust earnings, the average revenue per contract decreased \$107 to \$5,433 in the

three months ended September 30, 2016. The average revenue per burial contract increased 1.0% to \$8,822, while the number of burial contracts decreased 4.3% to 2,571. The number of cremation contracts increased 3.3% to 3,291 and the average revenue per same store cremation contract remained flat at \$3,259. The burial rate decreased 210 basis points to 40.4%, while the cremation rate increased 130 basis points to 51.7% for the three months ended September 30, 2016 when compared to the three months ended September 30, 2015. The average revenue for “other” contracts, which are charges for merchandise or services for which we do not perform a funeral service and which made up approximately 7.9% of the total number of contracts in the three months ended September 30, 2016, decreased 10.5% to \$2,328.

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Same store operating profit for the three months ended September 30, 2016 increased \$0.3 million, or 2.4%, when compared to the three months ended September 30, 2015. This increase is a result of better management of expenses, as we experienced a decrease of \$0.3 million from the same period in 2015. The most significant changes were in general liability and other insurance expenses, which decreased by \$0.6 million, facilities and grounds expenses, which decreased by approximately \$0.2 million and general and administrative expenses, which decreased by \$0.1 million, offset by a \$0.6 million increase in salaries and benefits.

Funeral home acquired operating revenues for the three months ended September 30, 2016 increased \$1.5 million, or 18.5%, when compared to the three months ended September 30, 2015 as we experienced a 24.7% increase in the total number of contracts to 1,620, while the average revenue per contract decreased 5.4% to \$6,184. The 2016 funeral home acquired portfolio includes three businesses acquired during 2016 not present in 2015. The average revenue per contract includes the impact of the funeral trust fund earnings recognized at the time that we provide the services pursuant to the preneed contract. Excluding funeral trust earnings, the average revenue per contract decreased \$314 to \$6,009 in the three months ended September 30, 2016. The average revenue per contract for burial contracts increased 0.9% to \$9,271 and the number of burial contracts increased 6.7% to 702. The number of cremation contracts increased 49.2% to 798 and the average revenue per cremation contract remained flat at \$4,022.

Acquired operating profit for the three months ended September 30, 2016 increased \$0.7 million, or 22.5%, from the three months ended September 30, 2015. This increase is a result of an increase in revenue, offset by a \$0.7 million or 16.6% increase in expenses. The most significant change was in salaries and benefits (the largest controllable expense), which increased \$0.6 million or 1.6% as a percentage of revenue compared to the same period in 2015.

The two categories of financial revenue consist of preneed funeral insurance commission revenue and preneed funeral trust earnings on matured preneed contracts. Preneed funeral insurance commission revenue remained flat at \$0.4 million for the three months ended September 30, 2016 compared to the same period in 2015. Preneed funeral insurance commission revenue is deferred for one year after the preneed funeral contracts are sold. In the third quarter of 2015, we sold 351 more preneed funeral contracts than in the same period of the previous year. Preneed funeral trust earnings decreased \$0.2 million, or 9.4%, in the three months ended September 30, 2016 as compared to the same period in 2015. Trust earnings include trust management fees charged by our wholly-owned registered investment advisor based on the fair market value of the trust assets. Operating profit for our two categories of financial revenue, on a combined basis, decreased 5.3% in the three months ended September 30, 2016 due primarily to the decrease in preneed funeral trust revenue.

The following tables set forth certain information regarding the revenues and operating profit from our funeral home operations for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015 (dollars in thousands):

	For the Nine		Change		
	Months Ended September 30, 2015	2016	Amount	%	
<b>Revenues:</b>					
Same store operating revenue	\$106,777	\$105,449	\$(1,328)	(1.2)	%
Acquired operating revenue	24,920	28,883	3,963	15.9	%
Preneed funeral insurance commissions	1,071	1,138	67	6.3	%
Preneed funeral trust earnings	5,959	5,482	(477)	(8.0)	%
Total	\$138,727	\$140,952	\$2,225	1.6	%
<b>Operating profit:</b>					
Same store operating profit	\$40,123	\$40,410	\$287	0.7	%
Acquired operating profit	9,950	12,002	2,052	20.6	%
Preneed funeral insurance commissions	281	577	296	105.3	%
Preneed funeral trust earnings	5,897	5,417	(480)	(8.1)	%
Total	\$56,251	\$58,406	\$2,155	3.8	%

Funeral home same store operating revenues for the nine months ended September 30, 2016 decreased \$1.3 million, or 1.2%, when compared to the nine months ended September 30, 2015. The decrease was due primarily to a decrease of 1.4% in same store contract volumes to 20,078, while the average revenue per contract increased slightly by 0.2% to \$5,252. The average revenue per contract excludes the impact of the preneed funeral trust earnings (separately reflected in Revenues above) recognized at the time that we provide the services pursuant to the preneed contract. Including preneed funeral trust earnings, the average revenue per contract decreased \$10 to \$5,449 in the nine months ended September 30, 2016. The average revenue per burial contract increased 1.7% to \$8,789, while the number of burial contracts decreased 5.4% to 8,196. The number of cremation contracts increased by 1.4% to 10,358, and the average revenue per same store cremation contract also increased 1.4% to \$3,265. The burial rate decreased 170 basis points to 40.8%, and the cremation rate increased 140 basis points to 51.6% for the nine months ended

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September 30, 2016 when compared to the nine months ended September 30, 2015. The average revenue for “other” contracts, which are charges for merchandise or services for which we do not perform a funeral service and which made up approximately 7.6% of the total number of contracts in the nine months ended September 30, 2016, increased 2.1% to \$2,338.

Same store operating profit for the nine months ended September 30, 2016 increased \$0.3 million or 0.7% compared to the nine months ended September 30, 2015, despite the decrease in operating revenues. This is primarily the result of better management of expenses which decreased \$1.2 million or 2.2% when compared to the same period in 2015. Those expenses with significant decreases include \$0.7 million of facilities and grounds expenses, \$0.4 million of general liability and other insurance expenses and \$0.1 million of bad debt expenses.

Funeral home acquired operating revenues for the nine months ended September 30, 2016 increased \$4.0 million, or 15.9%, when compared to the nine months ended September 30, 2015 as we experienced an 15.6% increase in the number of total contracts to 4,709, while the average revenue per contract decreased slightly by 0.1% to \$6,310. The 2016 funeral home acquired portfolio includes three businesses acquired during 2016 not present in 2015. The average revenue per contract includes the impact of the funeral trust fund earnings recognized at the time that we provide the services pursuant to the preneed contract. Excluding funeral trust earnings, the average revenue per contract increased \$17 to \$6,134 in the nine months ended September 30, 2016. The average revenue per burial contract increased 3.9% to \$9,234 and the number of burial contracts increased 5.3% to 2,163. The number of cremation contracts increased 27.7% to 2,189 and the average revenue per cremation contract increased 5.1% to \$4,049.

Acquired operating profit for the nine months ended September 30, 2016 increased \$2.1 million, or 20.6%, from the nine months ended September 30, 2015. This increase is a result of an increase in revenue, offset by a \$1.5 million or 13.2% increase in expenses. The most significant change was in salaries and benefits (the largest controllable expense), which increased \$1.0 million, general and administrative expenses increased \$0.2 million, facilities and grounds expenses increased \$0.2 million and general liability and other insurance expenses increased \$0.1 million. The two categories of financial revenue consist of preneed funeral insurance commission revenue and preneed funeral trust earnings on matured preneed contracts. Preneed funeral insurance commissions revenue increased by approximately \$0.1 million, or 6.3% for the nine months ended September 30, 2016 compared to the same period in 2015. Preneed funeral insurance commission revenue is deferred for one year after the preneed funeral contracts are sold. In the first nine months of 2015, we sold 857 more preneed funeral contracts than in the same period of the previous year. Preneed funeral trust earnings decreased by approximately \$0.5 million, or 8.0%, for the nine months ended September 30, 2016 compared to the same period in 2015. Preneed funeral trust earnings include trust management fees charged by our wholly-owned registered investment advisor based on the fair market value of the trust assets. Operating profit for the two categories of financial revenue, on a combined basis, decreased 3.0% in the nine months ended September 30, 2016 compared to the same period in 2015, due primarily to the decrease in preneed funeral trust revenue.

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Cemetery Segment. The following tables set forth certain information regarding the revenues and operating profit from the cemetery operations for the three months ended September 30, 2016 compared to three months ended September 30, 2015 (dollars in thousands):

	For the Three		Change		
	Months Ended	September 30,	Amount	%	
	2015	2016			
<b>Revenues:</b>					
Same store operating revenue	\$10,726	\$11,351	\$625	5.8	%
Acquired operating revenue	774	1,094	320	41.3	%
Cemetery trust earnings	2,385	2,025	(360)	(15.1)	%
Preneed cemetery finance charges	404	487	83	20.5	%
Total	\$14,289	\$14,957	\$668	4.7	%
<b>Operating profit:</b>					
Same store operating profit	\$3,066	\$3,324	\$258	8.4	%
Acquired operating profit	215	497	282	131.2	%
Cemetery trust earnings	2,312	1,954	(358)	(15.5)	%
Preneed cemetery finance charges	404	487	83	20.5	%
Total	\$5,997	\$6,262	\$265	4.4	%

Cemetery same store operating revenues for the three months ended September 30, 2016 increased \$0.6 million, or 5.8%, when compared to the three months ended September 30, 2015. Approximately 60.0% of our same store operating revenues were related to preneed sales of interment rights and related merchandise and services for the three months ended September 30, 2016. Preneed property revenue increased \$0.3 million, or 6.6%, as we experienced a 4.8% increase in the average price per interment to \$3,498, despite a 10.3% decrease in the number of preneed interment rights (property) sold to 1,624 in the three months ended September 30, 2016 from the same period in 2015. The increase in the average price per interment was a result of sales of higher valued interments at newly constructed gardens at several of our same store locations. Preneed merchandise and services revenue remained flat at \$1.1 million for the third quarter of 2016 as compared to the same period of 2015. Same store at-need revenue, which represents approximately 40.0% of our same store operating revenues, increased 5.3% due primarily to a 2.8% increase in the number of contracts to 3,158.

Cemetery same store operating profit for the three months ended September 30, 2016 increased \$0.3 million, or 8.4% from the same period in 2015. As a percentage of revenue, cemetery same store operating profit was 29.3% in the three months ended September 30, 2016 compared to 28.6% in the same period in 2015. The increase in operating profit was primarily a result of the increase in revenue, offset by a \$0.3 million, or 4.6%, increase in operating costs for the three months ended September 30, 2016 compared with the same period in 2015. Those expenses with significant increases include \$0.2 million of promotional expenses and \$0.1 million of salaries and benefits.

Cemetery acquired operating revenue and acquired operating profit increased in the third quarter of 2016 primarily due to an increase in preneed property revenue for the three months ended September 30, 2016 compared with the same period in 2015. Approximately 90% of the revenue and 85% of the operating profit for this portfolio is from the cemetery acquired in 2014.

The two categories of financial revenue consist of trust earnings and finance charges on preneed receivables. Trust earnings also include trust management fees charged by our wholly-owned registered investment advisor based on the fair market value of the trust assets. Total trust earnings decreased 15.1%, primarily due to a \$0.3 million decrease in merchandise and services trust income in the three months ended September 30, 2016 compared to the same period in 2015. Financial revenue earned from finance charges on the preneed contracts increased 20.5% in the three months ended September 30, 2016 compared to the same period in 2015, primarily as a result of our increased collection efforts.



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The following tables set forth certain information regarding the revenues and operating profit from our cemetery operations for the nine months ended September 30, 2016 compared to nine months ended September 30, 2015 (dollars in thousands):

	For the Nine		Change	
	Months Ended September 30, 2015	2016	Amount	%
<b>Revenues:</b>				
Same store operating revenue	\$32,260	\$34,771	\$2,511	7.8 %
Acquired operating revenue	2,526	2,634	108	4.3 %
Cemetery trust earnings	6,202	5,622	(580 )	(9.4 )%
Preneed cemetery finance charges	1,177	1,357	180	15.3 %
<b>Total</b>	<b>\$42,165</b>	<b>\$44,384</b>	<b>\$2,219</b>	<b>5.3 %</b>
<b>Operating profit:</b>				
Same store operating profit	\$10,153	\$11,216	\$1,063	10.5 %
Acquired operating profit	803	858	55	6.8 %
Cemetery trust earnings	5,992	5,407	(585 )	(9.8 )%
Preneed cemetery finance charges	1,177	1,357	180	15.3 %
<b>Total</b>	<b>\$18,125</b>	<b>\$18,838</b>	<b>\$713</b>	<b>3.9 %</b>

Cemetery same store operating revenues for the nine months ended September 30, 2016 increased \$2.5 million, or 7.8%, when compared to the nine months ended September 30, 2015. Approximately 60.0% of our same store operating revenues were related to preneed sales of interment rights (property) and related merchandise and services for the nine months ended September 30, 2016. Preneed property revenue increased \$1.8 million, or 10.9%, as we experienced a 6.7% increase in the average price per interment to \$3,136, while the number of preneed interment rights sold decreased 4.3% to 5,546 in the nine months ended September 30, 2016 from the same period in 2015. The increase in the average price per interment was a result of sales of higher valued interments at newly constructed gardens at several of our same store locations. Additionally, preneed merchandise and services revenue increased approximately 1.1% for our same store locations. Same store at-need revenue, which represents approximately 40.0% of our same store operating revenues, increased 5.3% due primarily to a 5.1% increase in the number of contracts to 10,242.

Cemetery same store operating profit for the nine months ended September 30, 2016 increased \$1.1 million, or 10.5%. As a percentage of same store revenue, cemetery same store operating profit increased to 32.3% in the nine months ended September 30, 2016 from 31.5% in the same period in 2015. The increase in operating profit was primarily a result of the increase in revenue, offset by \$1.3 million or 7.2% increase in operating costs for the nine months ended September 30, 2016 compared with the same period in 2015. Those expenses with significant increases include \$0.6 million of promotional expenses, \$0.3 million of bad debt expense, \$0.3 million of salaries and benefits and \$0.1 million of general and administrative expenses.

Cemetery acquired revenue and operating profit increased in the nine months ended September 30, 2016 primarily due to a 16.1% increase in preneed property revenue, as operating costs remained flat compared with the same period in 2015.

The two categories of financial revenue consist of trust earnings and finance charges on preneed receivables. Trust earnings also include trust management fees charged by our wholly-owned registered investment advisor based on the fair market value of the trust assets. Total trust earnings decreased by 9.4%, primarily due to a \$0.3 million decrease in merchandise and services trust income and a \$0.2 million decrease in perpetual care trust income in the nine months ended September 30, 2016 compared to the same period in 2015. Financial revenue earned from finance charges on the preneed contracts increased 15.3% in the nine months ended September 30, 2016 compared to the same period in 2015, primarily as a result of our increased collection efforts.

Other Financial Statement Items

**Depreciation and Amortization Costs.** Depreciation and Amortization costs for the field and home office totaled \$3.8 million for the three months ended September 30, 2016, an increase of \$0.4 million, or 10.8%, from the three months ended September 30, 2015 and \$11.5 million for the nine months ended September 30, 2016, an increase of \$1.4 million, or 13.6%, from the nine months ended September 30, 2015. These increases were primarily attributable to additional depreciation expense from assets acquired in our recent acquisitions, as well as from our newly constructed funeral homes which began operating in the latter half of 2015.

**Regional and Unallocated Funeral and Cemetery Costs.** Regional and unallocated funeral and cemetery costs consist of salaries and benefits for regional management, field incentive compensation and other related costs for field infrastructure. Regional and unallocated funeral and cemetery costs decreased \$0.1 million, or 4.3%, for the three months ended September 30, 2016 compared to the same period in 2015, primarily due to a \$0.1 million decrease in other administrative expenses. Regional and

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unallocated funeral and cemetery costs for the nine months ended September 30, 2016 increased by \$0.8 million, or 10.4%, from the same period in 2015 primarily due to a \$0.9 million increase in field incentive compensation and a \$0.2 million increase in severance expense, offset by a \$0.2 million decrease in salaries and benefits and a \$0.1 million decrease in other administrative expenses. In 2015, a substantial amount of the incentive compensation charges were recorded in the fourth quarter.

**General and Administrative Costs and Expenses.** General and administrative expenses totaled \$6.1 million for the three months ended September 30, 2016, a decrease of \$0.1 million, or 1.7%, from the three months ended September 30, 2015. The decrease was primarily attributable to a \$0.7 million decrease in non-cash stock compensation expense, a \$0.4 million decrease in incentive compensation and a \$0.3 million decrease in general and administrative expense. These decreases were offset by an increase of \$1.2 million in severance expense for the executive that retired in September 2016 and an increase of \$0.1 million in acquisition costs.

General and administrative expenses totaled \$21.2 million for the nine months ended September 30, 2016, an increase of \$0.9 million, or 4.5%, from the nine months ended September 30, 2015. The increase was primarily attributable to a \$3.2 million increase in severance expense related to the retirement of two former executives, \$0.2 million increase in acquisition costs, offset by a decrease of \$1.1 million in non-cash stock compensation expense, \$0.9 million in salaries and benefits, \$0.4 million in other general and administrative expenses and \$0.1 million in incentive compensation.

**Interest Expense.** Interest expense was \$2.9 million for the three months ended September 30, 2016 compared to \$2.6 million for the three months ended September 30, 2015, an increase of approximately \$0.3 million. During the three months ended September 30, 2016, interest expense related to our term note and revolving credit facility increased by approximately \$0.3 million compared to the same period in 2015, as a result of a higher principal balance and a higher interest rate during the current period. We currently pay interest at a prime rate or a LIBOR rate plus an applicable margin based upon our leverage ratio as determined by our Credit Agreement. During the three months ended September 30, 2016, the weighted average interest rate increased 0.2% compared to the same period in 2015, as a result of an increase in our leverage ratio.

Interest expense was \$8.7 million for the nine months ended September 30, 2016 compared to \$7.7 million for the nine months ended September 30, 2015, an increase of approximately \$1.0 million. During the nine months ended September 30, 2016, interest expense related to our term note and revolving credit facility increased by approximately \$1.1 million, as a result of a higher principal balance and higher interest rate during the current period, offset by a decrease in the amortization of debt issuance costs related to the credit facility of \$0.1 million compared to the same period in 2015. During the nine months ended September 30, 2016, the weighted average interest rate increased 0.3% compared to the same period in 2015, as a result of an increase in our leverage ratio.

**Accretion of Discount on Convertible Subordinated Notes.** For the three and nine months ended September 30, 2016, we recognized accretion of the discount on our convertible subordinated notes issued in March 2014 of \$1.0 million and \$2.9 million, respectively, compared to \$0.9 million and \$2.6 million for the three and nine months ended September 30, 2015, respectively. Accretion is calculated using the effective interest method based on a stated interest rate of 6.75%.

**Loss on Early Extinguishment of Debt.** In February 2016, we entered into the Seventh Amendment (as defined below under Debt Obligations) to our Credit Facility. As a result, we recognized a loss of \$0.6 million to write-off the related unamortized debt issuance costs during the nine months ended September 30, 2016.

**Other Income.** For the three months ended ended September 30, 2016, we recognized a net loss of \$0.3 million in connection with the sale of certain real estate and an impairment of tradenames. The impairment of tradenames was for the funeral home business held for sale at September 30, 2016, as the carrying value of this funeral home's tradename exceeded its fair value.

For the nine months ended ended September 30, 2016, we recognized a \$20,000 net gain on the sale of certain real estate and an impairment of tradenames. The impairment of tradenames was for the funeral home business held for sale at September 30, 2016, as the carrying value of this funeral home's tradename exceeded its fair value.

**Income Taxes.** Income tax expense during interim periods is based on our estimated annual effective income tax rate plus any discrete items, which are recorded in the period in which they occur. Discrete items include, among others, such events as changes in estimates due to the finalization of tax returns, tax audit settlements, and increases or

decreases in valuation allowances on deferred tax assets.

Income tax expense was \$1.9 million for the three months ended September 30, 2016 compared to \$2.8 million for the three months ended September 30, 2015. We recorded income taxes at the estimated effective rate, before discrete items, of 40.0% for the three months ended September 30, 2016 compared to 38.7% for the three months ended September 30, 2015. Income tax expense was \$8.4 million for the nine months ended September 30, 2016 compared to \$10.5 million for the nine months ended September 30, 2015. We recorded income taxes at the estimated effective tax rate, before discrete items, of 40.0% for both the nine months ended September 30, 2016 and 2015.

During the third quarter of 2016, we recognized a tax benefit of \$1.1 million which reduced our effective tax rate to 35.2% for the nine months ended September 30, 2016. The following items affected our effective tax rate for the nine months ended September 30, 2016:

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We recorded an income tax benefit as a result of a favorable settlement of uncertain tax positions in the state of California and an income tax benefit related to the conclusion of a “no change” Internal Revenue Service audit of our 2013 tax year.

We recorded an income tax benefit related to the increase in the overall accumulated deferred tax asset caused by the imposition of a unitary tax regime in the state of New York effective January 1, 2015, impacting the state return filed in September 2016.

We recorded an income tax benefit related to state bonus depreciation as a result of finalization of state returns.

We recorded other expense adjustments related to our valuation allowance and certain interim rate changes.

We have approximately \$44.0 million of state net operating loss carry forwards that will expire between 2017 and 2037, if not utilized. Based on management's assessment of the various state net operating losses, it has been determined that it is more likely than not that we will not be able to realize the tax benefits of certain portions of the state losses. Accordingly, a valuation allowance has been established and the deferred tax asset for the state operating losses is reviewed every quarter. At September 30, 2016, the valuation allowance totaled \$0.3 million.

**LIQUIDITY AND CAPITAL RESOURCES**

Our primary sources of liquidity and capital resources are internally generated cash flows from operating activities and availability under our Credit Facility.

We generate cash in our operations primarily from at-need sales and delivery of preneed sales. We also generate cash from earnings on our cemetery perpetual care trusts. Based on our recent operating results, current cash position and anticipated future cash flows, we do not anticipate any significant liquidity constraints in the foreseeable future. However, if our capital expenditures or acquisition plans change, we may need to access the capital markets to obtain additional funding. Further, to the extent operating cash flow or access to and cost of financing sources are materially different than expected, future liquidity may be adversely affected. Please read Part I, Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015.

We intend to use cash on hand and borrowings under our Credit Facility primarily to acquire funeral home and cemetery businesses and for internal growth projects, such as cemetery inventory development and funeral home expansion projects. We have the ability to draw on our revolving credit facility, subject to customary terms and conditions of the Credit Agreement. We believe that our existing cash balance, future cash flows from operations and borrowings under our Credit Facility described below will be sufficient to meet our anticipated working capital requirements, capital expenditures, scheduled debt payments, commitments, dividends and acquisitions for the foreseeable future.

**Cash Flows**

We began 2016 with \$0.5 million in cash and other liquid investments and ended the third quarter with \$0.8 million in cash. As of September 30, 2016, we had borrowings of \$63.3 million outstanding on our revolving credit facility compared to \$92.6 million outstanding as of December 31, 2015.

The following table sets forth the elements of cash flow for the nine months ended September 30, 2015 and September 30, 2016 (in millions):

	For the Nine Months Ended September 30, 2015 2016	
Cash at January 1st	\$0.4	\$0.5
Cash flow provided by operating activities	43.0	34.3
Acquisitions and land for new construction	(4.3 )	(15.1)
Purchase of land and buildings previously leased	(6.1 )	(6.3 )
Net proceeds from the sale of businesses and other assets	—	1.0
Growth capital expenditures	(15.9)	(6.8 )

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Maintenance capital expenditures	(6.9 )	(5.2 )
Net borrowings on our revolving credit facility, term loan and long-term debt obligations	14.8	0.3
Dividends on common stock	(1.4 )	(1.7 )
Purchases of treasury stock	(23.9)	—
Payment of loan origination costs related to the credit facility	—	(0.7 )
Other financing proceeds	0.7	0.5
Cash at September 30th	\$0.4	\$0.8

For the nine months ended September 30, 2016, cash provided by operating activities was \$34.3 million compared to cash provided by operating activities of \$43.0 million for the nine months ended September 30, 2015, a decrease of \$8.7 million, due primarily to unfavorable working capital changes, which included an increase in tax payments due to becoming a tax payer in the latter half of 2015, an increase in preneed financed receivables, offset by favorable changes in accrued severance for the retirement of a former executive that has not been fully paid.

Our investing activities resulted in a net cash outflow of \$32.4 million for the nine months ended September 30, 2016 compared to \$33.1 million for the nine months ended September 30, 2015, a decrease of \$0.7 million. During the nine months ended September 30, 2016, we acquired three funeral home businesses for approximately \$15.8 million. The purchase price consisted of \$12.35 million paid in cash at closing and \$6.5 million of deferred purchase price payments. The net present value of such future deferred purchase price payments for these funeral home businesses was \$3.5 million. We purchased land for funeral home expansion projects for approximately \$2.7 million.

Additionally, we purchased land and buildings at four funeral home locations that were previously leased for approximately \$6.3 million. Capital expenditures totaled \$12.0 million, of which \$6.8 million and \$5.2 million were growth and maintenance capital expenditures, respectively, for the nine months ended September 30, 2016. Our growth capital expenditures were primarily construction costs related to funeral home facilities of approximately \$2.3 million, renovations at certain business locations of \$1.3 million and cemetery development costs of \$3.2 million.

Maintenance capital expenditures in the nine months ended September 30, 2016 were primarily related to vehicle purchases of \$1.2 million, general equipment and furniture purchases of \$1.6 million and maintenance projects such as paving roads, parking lots, facility repairs and general improvements of \$2.4 million.

During the nine months ended September 30, 2015, we acquired a funeral home business for approximately \$8.8 million. The purchase price consisted of \$4.25 million paid in cash at closing and \$4.5 million, the net present value of future deferred payments totaling \$5.5 million. We also purchased land and buildings at three funeral home businesses that were previously leased under operating leases for approximately \$6.1 million. Capital expenditures totaled \$22.8 million, of which \$15.9 million and \$6.9 million were growth and maintenance capital expenditures, respectively, for the nine months ended September 30, 2015. Our growth capital expenditures were primarily related to construction costs related to three new funeral home facilities of approximately \$9.3 million, renovations at certain business locations of \$4.4 million and cemetery development costs of \$2.2 million. Maintenance capital expenditures in the nine months ended September 30, 2015 were primarily related to maintenance projects such as paving roads, parking lots, facility repairs and improvements of \$2.3 million, vehicle purchases of \$1.7 million, information technology infrastructure and systems improvements of approximately \$1.5 million and general equipment and furniture purchases of \$1.4 million.

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Our financing activities resulted in a net cash outflow of \$1.6 million for the nine months ended September 30, 2016 compared to \$9.9 million for the nine months ended September 30, 2015, a decrease of \$8.3 million. During the nine months ended September 30, 2016, we had net borrowings on our revolving credit facility and term loan of \$1.3 million. We also paid transaction costs of approximately \$0.7 million related to the Seventh Amendment of our Credit Facility. During the nine months ended September 30, 2015, we had net borrowings on our revolving credit facility and term loan of \$15.5 million. We also purchased treasury stock for approximately \$23.9 million.

### Dividends

On May 19, 2016, our Board approved an increase in our quarterly dividend on our common stock from \$0.025 to \$0.050 per share, effective with respect to dividends payable on September 1, 2016 and later. On August 1, 2016 our Board declared a dividend of \$0.050 per share, totaling approximately \$0.8 million, which was paid on September 1, 2016 to record holders of our common stock as of August 16, 2016. For the nine months ended September 30, 2015 and 2016, we paid total dividends of approximately \$1.4 million and \$1.7 million, respectively. We have a dividend reinvestment program so that stockholders may elect to reinvest their dividends into additional shares of our common stock.

### Share Repurchase Program

On February 25, 2016, our Board approved a share repurchase program authorizing us to purchase up to an aggregate of \$25.0 million of our common stock in accordance with Rule 10b-18 of the Exchange Act. The shares may be purchased from time to time in the open market or in privately negotiated transactions. Purchases will be at times and in amounts as management deems appropriate based on factors such as market conditions, legal requirements and other business considerations. During the three and nine months ended September 30, 2016, we did not repurchase any shares of common stock.

### Debt Obligations

The outstanding principal of our total long-term debt and capital lease obligations at September 30, 2016 totaled \$215.4 million and consisted of \$141.6 million under our term loan, \$63.3 million outstanding under our revolving credit facility and \$10.5 million in acquisition indebtedness and capital lease obligations.

As of September 30, 2016, we had a \$300 million secured bank credit facility with Bank of America, N.A. as Administrative Agent (the "Credit Agreement"), comprised of a \$150 million revolving credit facility and a \$150 million term loan (collectively, the "Credit Facility"). The Credit Facility also contains an accordion provision to borrow up to an additional \$75 million in revolving loans, subject to certain conditions. The Credit Facility is collateralized by all personal property and funeral home real property in certain states.

On February 9, 2016, we entered into a seventh amendment (the "Seventh Amendment") to our Credit Facility. The Seventh Amendment resulted in, among other things, (i) reducing our LIBOR based variable interest rate 37.5 basis points, (ii) extending the maturity so that the Credit Agreement will mature at the earlier of (a) any date that is 91 days prior to the maturity of any subordinated debt (including the \$143.75 million in principal amount of the Convertible Notes) or (b) February 9, 2021, (iii) increasing and funding the term loan so that \$150 million was outstanding upon the effectiveness of the Seventh Amendment, (iv) reducing the size of the revolver to \$150 million, (v) increasing the accordion to \$75 million and (vi) updating the amortization payments for the term loan facility so that the borrowings under the term loan facility are subject to amortization payments of \$2.81 million at the end of each fiscal quarter beginning with the fiscal quarter ending March 31, 2016 through the fiscal quarter ending December 31, 2017, \$3.75 million at the end of each fiscal quarter beginning with the fiscal quarter ending March 31, 2018 through the fiscal quarter ending March 31, 2020 and \$4.69 million at the end of each fiscal quarter beginning with the fiscal quarter ending June 30, 2020 through the fiscal quarter ending December 31, 2020.

No letters of credit were issued and outstanding under the Credit Facility at September 30, 2016. Under the Credit Facility, outstanding borrowings bear interest at either a prime rate or a LIBOR rate, plus an applicable margin based upon our leverage ratio. At September 30, 2016, the prime rate margin was equivalent to 1.13% and the LIBOR margin was 2.13%. The weighted average interest rate on the Credit Facility for both the three and nine months ended September 30, 2016 was 2.8%.

We have no material assets or operations independent of our subsidiaries. All assets and operations are held and conducted by our subsidiaries, each of which have fully and unconditionally guaranteed our obligations under the

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

We were in compliance with the covenants contained in the Credit Agreement as of September 30, 2016. The Credit Agreement contains key ratios with which we must comply, including a requirement to maintain a leverage ratio of no more than 3.5 to 1.00 and a covenant to maintain a fixed charge coverage ratio of no less than 1.20 to 1.00. As of September 30, 2016, the leverage ratio was 2.96 to 1.00 and the fixed charge coverage ratio was 2.40 to 1.00.

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Debt issuance costs, net of accumulated amortization, of \$1.3 million related to the Credit Facility are being amortized over the term of the related debt using the effective interest method for our term loan and the straight line method for our revolving credit facility. Amortization of debt issuance costs related to our Credit Facility was approximately \$0.1 million for both the three months ended September 30, 2015 and 2016 and \$0.4 million and \$0.3 million for the nine months ended September 30, 2015 and 2016, respectively.

**Convertible Subordinated Notes due 2021**

On March 19, 2014, we issued \$143.75 million aggregate principal amount of 2.75% convertible subordinated notes due March 15, 2021 (the "Convertible Notes"). The Convertible Notes bear interest at 2.75% per year. Interest on the Convertible Notes began to accrue on March 19, 2014 and is payable semi-annually in arrears on March 15 and September 15 of each year.

At September 30, 2016, the carrying amount of the equity component was approximately \$18.0 million. At September 30, 2016, the principal amount of the liability component was \$143.75 million and the net carrying amount was \$118.5 million. The unamortized discount of \$22.9 million and the unamortized debt issuance costs of \$2.4 million as of September 30, 2016 are being amortized using the effective interest method over the remaining term of the Convertible Notes. The effective interest rate on the unamortized discount and the debt issuance costs for the three and nine months ended September 30, 2015 and 2016 was 6.75% and 2.75%, respectively.

Interest expense on the Convertible Notes included contractual coupon interest expense of approximately \$1.0 million for both the three months ended September 30, 2015 and 2016 and \$3.0 million for both the nine months ended September 30, 2015 and 2016, respectively. Amortization of debt issuance costs related to our Convertible Notes was approximately \$0.1 million for both the three months ended September 30, 2015 and 2016 and \$0.4 million for both the nine months ended September 30, 2015 and 2016, respectively. Accretion of the discount on the Convertible Notes was \$0.9 million and \$1.0 million for the three months ended September 30, 2015 and 2016, respectively, and \$2.6 million and \$2.9 million for the nine months ended September 30, 2015 and 2016, respectively.

During the three months ended September 30, 2016, an adjustment to the conversion rate of the Convertible Notes was triggered when our Board increased the dividends declared per common share from \$0.025 per share to \$0.05 per share. The initial conversion rate of the Convertible Notes was 44.3169 shares of our common stock per \$1,000 principal amount of Convertible Notes, equivalent to an initial conversion price of approximately \$22.56 per share of common stock. The adjusted conversion rate of the Convertible Notes is 44.3639 shares of our common stock per \$1,000 principal amount of Convertible Notes, equivalent to an adjusted conversion price of approximately \$22.54 per share of common stock.

**SEASONALITY**

Our business can be affected by seasonal fluctuations in the death rate. Generally, the death rate is higher during the winter months because the incidences of death from influenza and pneumonia are higher during this period than other periods of the year.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

In the ordinary course of business, we are typically exposed to a variety of market risks. Currently, these are primarily related to interest rate risk and changes in the values of securities associated with the preneed and perpetual care trusts. Management is actively involved in monitoring exposure to market risk and developing and utilizing appropriate risk management techniques when appropriate and when available for a reasonable price. We are not exposed to any other significant market risks.

The following quantitative and qualitative information is provided about financial instruments to which we are a party at September 30, 2016 and from which we may incur future gains or losses from changes in market conditions. We do not enter into derivative or other financial instruments for speculative or trading purposes.

Hypothetical changes in interest rates and the values of securities associated with the preneed and perpetual care trusts chosen for the following estimated sensitivity analysis are considered to be reasonable near-term changes generally based on consideration of past fluctuations for each risk category. However, since it is not possible to accurately predict future changes in interest rates, these hypothetical changes may not necessarily be an indicator of probable future fluctuations.

The following information about our market-sensitive financial instruments constitutes a "forward-looking statement."

In connection with our preneed funeral operations and preneed cemetery merchandise and service sales, the related funeral and cemetery trust funds own investments in equity and debt securities and mutual funds, which are sensitive to current market prices. Cost and market values of such investments as of September 30, 2016 are presented in Item 1, "Condensed Notes to Consolidated Financial Statements," Notes 5 and 8 to our Consolidated Financial Statements in this Form 10-Q. See also Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-Q. The sensitivity of the fixed income securities is such that a 0.25% change in interest rates causes an approximate 1.49% change in the value of the fixed income securities.

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We monitor current and forecasted interest rate risk in the ordinary course of business and seek to maintain optimal financial flexibility, quality and solvency. As of September 30, 2016, we had outstanding borrowings of \$63.3 million under our \$150.0 million revolving credit facility and approximately \$141.6 million outstanding on our term loan. Any further borrowings or voluntary prepayments against the revolving credit facility or any change in the floating rate would cause a change in interest expense. We have the option to pay interest under the Credit Facility at either prime rate or LIBOR rate plus a margin. At September 30, 2016, the prime rate margin was equivalent to 1.13% and the LIBOR margin was 2.13%. Assuming the outstanding balance remains unchanged, a change of 100 basis points in our borrowing rate would result in a change in income before taxes of \$2.0 million. We have not entered into interest rate hedging arrangements in the past. Management continually evaluates the cost and potential benefits of interest rate hedging arrangements.

Our Convertible Notes bear interest at a fixed rate of 2.75% per year. The Convertible Notes do not contain a call feature. At September 30, 2016, the fair value of these notes was approximately \$169.6 million based on the last traded or broker quoted price. The remainder of our long-term debt and leases consist of non-interest bearing notes and fixed rate instruments that do not trade in a market and do not have a quoted market value. Increases in market interest rates may cause the fair value of these debt instruments to decrease but such changes will not affect our interest costs.

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Item 4. Controls and Procedures

Management's Evaluation of Disclosure Controls and Procedures

Our management, including our principal executive and financial officers, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this Form 10-Q. Our disclosure controls and procedures are designed to ensure that the information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and to ensure that such information is accumulated and communicated to management, including our principal executive and financial officers, as appropriate, to allow timely decisions regarding required disclosure. Based on such evaluation, our principal executive and financial officers have concluded that our disclosure controls and procedures were effective as of September 30, 2016 (the end of the period covered by this Form 10-Q) at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our system of internal control over financial reporting (defined in Rules 13a-15(f) or 15d-15(f) under the Exchange Act) during the fiscal quarter covered by this quarterly report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We and our subsidiaries are parties to a number of legal proceedings that arise from time to time in the ordinary course of our business. While the outcome of these proceedings cannot be predicted with certainty, we do not expect these matters to have a material adverse effect on our financial statements. We self-insure against certain risks and carry insurance with coverage and coverage limits for risk in excess of the coverage amounts consistent with our assessment of risks in our business and of an acceptable level of financial exposure. Although there can be no assurance that self-insurance reserves and insurance will be sufficient to mitigate all damages, claims, or contingencies, we believe that the reserves and our insurance provides reasonable coverage for known asserted and unasserted claims. In the event we sustain a loss from a claim, and the insurance carrier disputes coverage or coverage limits, we may record a charge in a different period than the recovery, if any, from the insurance carrier.

Item 1A. Risk Factors

There have been no material changes in our risk factors as previously disclosed in Part I, Item 1A. “Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2015. Readers should carefully consider the factors discussed in Part I, Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K for the year ended December 31, 2015 are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

Item 6. Exhibits

The exhibits required to be filed pursuant to the requirements of Item 601 of Regulation S-K are set forth in the Exhibit Index accompanying this Form 10-Q and are incorporated herein by reference.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CARRIAGE SERVICES, INC.

Date: October 26, 2016 /s/ Viki K. Blinderman

Viki K. Blinderman

Co-Chief Financial Officer, Chief Accounting Officer and Secretary

(Duly Authorized Officer and Principal Accounting Officer)

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CARRIAGE SERVICES, INC.

INDEX OF EXHIBITS

Exhibit No.	Description
*31.1	Certification of Periodic Financial Reports by Melvin C. Payne in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of Periodic Financial Reports by Carl B. Brink in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002.
**32	Certification of Periodic Financial Reports by Melvin C. Payne and Carl B. Brink in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002 and 18 U.S.C. Section 1350.
10.1	Retirement and Release Agreement dated September 30, 2016 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed October 3, 2016.)
*101	Interactive Data Files.

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\* Filed herewith.

\*\* Furnished herewith.