CARRIAGE SERVICES INC
Form 10-K
February 23, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended, December 31, 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 incorporation or organization)	(I.R.S. Employer Identification No.)
3040 Post Oak Blvd., Suite 300, Houston, Texas	77056
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (713) 332-8400
Securities registered pursuant to Section 12(b) of the Act:

(Title of each class)	(Name of each exchange on which registered)
Common Stock, $.01 Par Value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes ¨ No ý
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ¨ No ý
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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
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 definitions of "large accelerator filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	ý

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 Securities Exchange Act of 1934. Yes ¨ No ý
The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2016 was approximately $350.4 million based on the closing price of $23.68 per share on the New York Stock Exchange.
The number of shares of the registrant's Common Stock, $.01 par value per share, outstanding as of February 20, 2017 was 16,660,755.
DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its 2017 annual meeting of stockholders, which will be filed with the Securities and Exchange Commission within 120 days of December 31, 2016, are incorporated in Part III of this Annual Report on Form 10-K.

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CAUTIONARY NOTE

Certain statements and information in this Annual Report on Form 10-K (this “Form 10-K”) may constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. The words “may,” “estimate,” “believe,” “expect,” “anticipate,” “plan,” “intend,” “foresee,” “should,” “would,” “could” or other similar e intended to identify forward-looking statements, which are generally not historical in nature. These forward-looking statements include, but are not limited to, statements regarding any projections of earnings, revenues, asset sales, cash flow, debt levels or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements 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. 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;
- our ability to execute our growth strategy;
- the effects of competition;
- the execution of our Standards Operating, 4E leadership and Standard 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 funeral and cemetery industry; and
- other factors and uncertainties inherent in the funeral and cemetery industry.

For additional information regarding known material factors that could cause our actual results to differ from our projected results, please see Part I, Item 1A, Risk Factors.

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

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PART I

ITEM 1. BUSINESS.

GENERAL

Carriage Services, Inc. (“Carriage,” the “Company,” “we,” “us,” or “our”) was incorporated in the State of Delaware in December 1993 and is a leading provider of funeral and cemetery services and merchandise in the United States. We operate in two business segments: funeral home operations, which currently account for approximately 76% of our total revenue, and cemetery operations, which currently account for approximately 24% of our total revenue.

Our funeral homes offer a complete range of services to meet a family’s deathcare needs, including consultation, the removal and preparation of remains, the sale of caskets and related funeral merchandise, the use of funeral home facilities for visitation and services and transportation services. Our cemeteries are primarily sales businesses that sell interment rights (grave sites and mausoleum spaces) and related merchandise, such as markers and outer burial containers.

At December 31, 2016, we operated 170 funeral homes in 28 states and 32 cemeteries in 11 states. We compete with other public funeral and cemetery companies and smaller, independent operators. We 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.

CURRENT YEAR DEVELOPMENTS

Acquisitions. During 2016, we acquired six funeral home businesses. We acquired two funeral home businesses in Houston, Texas in May 2016, one funeral home business in Madera, California in September 2016, one funeral home business in Brookfield, Wisconsin in November 2016 and two funeral home businesses in Burlington, North Carolina and Graham, North Carolina in November 2016. The pro forma impact of the acquisitions on prior periods is not presented as the impact is not material to our reported results. The results of the acquired businesses are included in our results of operations from the date of acquisition.

Credit Facility. 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 2.75% Convertible Subordinated Notes issued on or about March 19, 2014 and due March 15, 2021 (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 (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.

Commitments. Effective April 30, 2016, we terminated an agreement to outsource the processing of transactions for our cemetery business and certain accounting activities. At that time, all transaction processing returned in-house and we retained most of the personnel of the service provider that resided in our home office.

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 year ended December 31, 2016, we did not repurchase any shares of common stock pursuant to this share repurchase program.

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

Board Of Directors. On August 9, 2016, Richard W. Scott resigned from the Board. At the time of his resignation, Mr. Scott was 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.

Dividends. On May 19, 2016, the Board approved an increase in our quarterly cash dividend on our common stock from $0.025 to $0.05 per share, effective with respect to dividends payable on September 1, 2016 and later. For our 2016 fiscal year, we paid approximately $2.5 million in dividends.

FUNERAL AND CEMETERY INDUSTRY

Funeral home and cemetery businesses provide products and services to families in three principal areas: (i) ceremony and tribute, generally in the form of a funeral or memorial service; (ii) disposition of remains, either through burial or cremation; and (iii) memorialization, generally through monuments, markers or inscriptions. The funeral and cemetery industry in the United States is characterized by the following fundamental attributes (the industry statistics and information included in this Form 10-K are from reports compiled by Sundale Research based on information as of September 30, 2016 from the U.S. Department of Commerce).

Deaths and Death Trends

During 2016, the number of deaths in the United States increased by approximately 1.3% following a 1.9% and a 1.1% increase in 2015 and 2014, respectively. The rapidly growing and aging population (more than half of the U.S. population will be over the age of 50 within the next five years), is expected to result in an increase in the number of deaths annually. The number of Americans age 65 and over is expected to increase from 46.8 million in 2015 to 54.1 million in 2020, reflecting an average annual growth rate of 2.9%. Overall, the number of deaths in the United States is expected to increase by an average of 1.6% per year reaching an estimated 2.9 million in 2020.

Burial and Cremation Trends

While the number of deaths is expected to increase over the next few years, the burial rate is expected to continue to decline, however, the cremation rate is expected to continue to increase. In 2016, the number of burials in the United States decreased by an estimated 1.3%, following declines of 1.2% and 1.5% in 2015 and 2014, respectively. The number of burials in the United States is estimated to fall by an average of 1.1% per year from 2015 through 2020, as the burial rate is expected to decrease by more than six percentage points during this time. In 2016, the burial rate was estimated to be 50.4% and is estimated to fall to 45.1% in 2020. It is estimated that there will be approximately 1.31 million burials in 2020 declining from 1.36 million in 2016.

In 2016, the number of cremations in the United States increased by an estimated 3.9%, following increases of 5.3% and 4.4% in 2015 and 2014, respectively. Slower growth is expected through 2020, due in part to the sheer size of the market for cremations; however, shifting preferences will continue to lead to a considerable rise in cremations. The number of cremations in the United States is expected to grow by an average of 4.3% per year through 2020. In 2020, it is estimated that there will be approximately 1.59 million cremations in the United States and a cremation rate of 54.9%.

Highly Fragmented Ownership

Our industry, after over 50 years of consolidation, remains highly fragmented, and succession planning issues for privately-owned funeral and cemetery businesses have become more difficult and complex than ever. We believe Carriage provides a unique consolidation and operating framework that offers a highly attractive succession planning solution for owners who want their legacy family business to remain operationally prosperous in their local communities. We also believe that our decentralized operating model will continue to attract the top entrepreneurial talent in our industry. Our focus is on partnering with the best of the remaining independent funeral home and cemetery owners in major strategic markets around the country where the potential for future revenue growth is the highest.

The largest public operators, in terms of revenue, of both funeral homes and cemeteries in the United States are Service Corporation International ("SCI"), StoneMor Partners L.P. ("StoneMor") and Carriage. We believe these three companies collectively represent approximately 20% of funeral and cemetery revenues in the United States. Independent businesses, along with a few privately-owned consolidators, represent the remaining amount of industry revenue, accounting for an estimated 80% share of revenues.

Heritage and Tradition

Funeral home and cemetery businesses have traditionally been family-owned businesses that have built a local heritage and tradition through successive generations, providing a foundation for ongoing business opportunities from established client family relationships and related referrals. Given the sensitive nature of our business, we believe that relationships fostered at the local level build trust in the community and are a key driver of market share. While new entrants may enter any given market, the time and resources required to develop local heritage and tradition serve as important barriers to entry.

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BUSINESS STRATEGY

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 believe Carriage has the most innovative and transparent operating and reporting processes in the funeral and cemetery industry, which we are able to achieve through a decentralized, high-performance cultural operating framework linked with 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, which are comprised of:

- honesty, integrity and quality in all that we do;
- hard work, pride of accomplishment and shared success through employee ownership;
- belief in the power of people through individual initiative and teamwork;
- outstanding service and profitability go hand-in-hand; and
- growth of the Company is driven by decentralization and partnership.

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

Our 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 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 Operating Model and the underlying 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 our local managers and their teams. Our Standards Operating Model is 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.

Important elements of our Standards Operating Model include:

- Balanced Operating Model – We believe a decentralized structure works best in the funeral and cemetery industry. Successful execution of our Standards Operating Model is highly dependent on strong local leadership, intelligent risk taking, entrepreneurial drive and corporate support aligned with the key drivers of a successful operation organized around three primary areas - market share, people and operating financial metrics.
- Incentives Aligned with Standards – Empowering local managers, which we call Managing Partners, to do the right things in their operations and local communities, and providing appropriate support with operating and financial practices, will enable long-term growth and sustainable profitability. Each Managing Partner participates in a variable bonus plan whereby he or she earns a percentage of his or her respective business' earnings based upon the actual standards achieved as long as the performance exceeds our minimum standards. In 2012, we began a five year incentive plan, called "Good to Great," which rewards Managing Partners with a bonus at the end of five years, equal to a ratio of four to six times their average annual bonus, if they are able to achieve an annual compound growth rate of 2% over a five year period. After each five year incentive plan is achieved and paid out, a new five year plan begins. The initial five-year performance period commenced on January 1, 2012 and ended on December 31, 2016. For this performance period, we will payout approximately \$2.4 million to 12 Managing Partners who earned a bonus under this program. Their combined annual growth rate in Revenue and Field Level Operating Earnings was 4.9% and 10%, respectively.
- The Right Local Leadership – Successful execution of our operating model is highly dependent on strong local leadership as defined by our 4E Leadership Model, intelligent risk taking and entrepreneurial empowerment. A

Managing Partner's performance is judged according to achievement of the standards for that business.

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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.

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, earnings and cash flow. We believe a primary driver of higher revenue and profits in the future will be the execution of our Strategic Acquisition Model using strategic ranking criteria to assess acquisition 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.

We have learned that the long-term growth or decline of a local branded funeral and cemetery business is reflected by several criteria that correlate strongly with five to ten year performance in volumes (market share), revenues and sustainable field-level earnings before interest, taxes, depreciation and amortization (“EBITDA”) margins (a non-GAAP measure). We use the following criteria, to name a few, to rank the strategic position of each potential acquisition:

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

The valuation of the acquisition candidate is then determined through the application of an appropriate after-tax cash return on investment that exceeds our cost of capital.

Our belief in our Mission Statement and Guiding Principles that define us and proper execution of the three models that define our strategy have given us the competitive advantage in any market in which we compete. We believe that we can execute our three models without proportionate incremental investment in our consolidation platform infrastructure 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.

Other elements of our overall business strategy include the following:

Enhancement of Funeral and Cremation Services. Personalization and pre-planning continue to be two of the most important trends in the funeral and cremation services and merchandise industry, but the move toward more cremations may be the most significant. While this trend is expected to continue through at least 2020, other factors are expected to lead to rising industry revenues, including an increase in spending on additional or unique funeral and cremation services.

The percentage of funeral services performed by our funeral homes for which cremation was chosen was 47.3% for the year ended December 31, 2014, 48.9% for the year ended December 31, 2015 and 50.7% for the year ended December 31, 2016. For the year ended December 31, 2016, 66.1% of our total cremation services were direct cremations (where no memorial service or visitation is involved, although merchandise may be sold) and 33.9% included services, as compared to 65.8% and 34.2%, respectively, for the year ended December 31, 2015. Shifting preferences will likely continue to lead to a considerable rise in cremations; as such, we are focused on increasing the percentage of our cremation customers that choose additional services and products. All of our funeral homes offer cremation products and services. While the average revenue for a cremation service is generally lower than that of an average traditional, full-service funeral, we have found that these revenues can be substantially enhanced by our emphasis on offering additional services and merchandise, including counseling referrals, video tributes, flowers, burial garments and memorial items such as urns, keepsake jewelry and other items that hold a portion of the cremated remains.

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Preneed Funeral Sales Program. We operate under a local, decentralized preneed sales strategy whereby each business location customizes its preneed program to its local needs. Approximately 19% of our funeral services performed are funded through preneed contracts, which are usually secured by placing the funds collected in trust for the benefit of the customer or by the purchase of a life insurance policy, the proceeds of which will pay for such services at the time of need. Insurance-funded contracts allow us to earn commission income to improve our near-term cash flow and offset a significant amount of the up-front costs associated with preneed sales. Trust funded contracts typically provide cash that is invested in various securities with the expectation that returns will exceed the growth factor in the insurance contracts. The cash flow and earnings from insurance contracts are more stable, but are generally lower than traditional trust fund investments. In markets that depend on preneed sales for market share, we supplement the arrangements written by funeral directors with sales sourced by sales counselors and third party sellers.

Preneed Cemetery Sales Program. Our preneed cemetery strategy is to build family heritage in our cemeteries by selling property and internment rights prior to death through full time, highly motivated and entrepreneurial local sales teams. Approximately 45% of our cemetery revenues are derived from preneed property sales. Cemetery merchandise and services are often purchased in addition to cemetery property at the time of sale. The performance of these preneed cemetery contracts is secured by placing the funds collected in trust for the benefit of the customer, the proceeds of which will pay for such services at the time of need. General consumer confidence and discretionary income have a significant impact on our preneed sales success rate. In 2016, our preneed cemetery sales increased 7.3% compared to 2015.

OUR STRENGTHS

Market Leader. We compete with other public funeral and cemetery companies and smaller, independent operators and believe we are a market leader (first or second) in most of our markets. We focus on markets that perform better than the industry average and are generally insulated from material economic and demographic changes.

High Performance, Decentralized, Partnership Culture. Our funeral homes and cemeteries are managed by Managing Partners with extensive funeral and cemetery industry experience, often within their local markets. Our Managing Partners have responsibility for day-to-day operations, but are required to follow operating and financial standards based on our Standards Operating Model that are custom designed for each of our four business groupings which is based on the size (number of funerals) and average revenue per funeral. This strategy allows each local business to maintain its unique identity within its local market and to capitalize on its reputation and heritage while our senior leadership provides support services from our corporate headquarters in Houston, Texas. We believe our culture is very attractive to owners of premier independent businesses that fit our profile of suitable acquisition candidates.

Flexible Capital Structure. We have no near-term debt maturity issues. We believe that our capital structure provides us with financial flexibility by allowing us to invest our cash flow in growth opportunities, such as business acquisitions and cemetery inventory projects. For additional information regarding our capital structure, please see Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, Liquidity and Capital Resources.

Stable Cash Flow. We have demonstrated the ability to generate strong and stable cash flow. Cash flow from operations for 2016 totaled $49.5 million, which was used primarily for the acquisition of six funeral home businesses, capital expenditures and our working capital needs. We intend to use our cash flow to acquire funeral home and cemetery businesses and to fund internal growth projects, such as cemetery inventory development. Our growth strategy is the primary way we expect to increase stockholder value. While we reassess our capital allocation strategy annually, we currently believe that our financial goals will best be achieved by continuing to improve the operating and financial performance of our existing portfolio of businesses while selectively investing our net cash flow in growth opportunities that generate a return on invested capital in excess of our weighted average cost of capital.

Strong Field-Level Gross Profit Margins. We believe that we have strong field-level gross profit margins and that this performance is a testament to the success of our business strategies. Our strong margins and the ability to control costs are important advantages in a business such as ours that is characterized by a high fixed-cost structure. We will continue to seek ways to improve our financial performance, and we believe that our Standards Operating Model will continue to yield long-term improvement in our financial results.

Effective Execution of Funeral Preneed Sales. We believe our local, decentralized strategy allows us to adapt our preneed sales selectively to best address the competitive situation in our particular markets. In highly competitive markets, we execute a more aggressive preneed sales program. In less competitive markets where we have a strong market position, we deploy a more passive preneed sales program. In certain of our markets, we do not deploy a formal preneed program. This approach allows us to target the investment in preneed sales to markets where we have the opportunity to reinforce our market share. Since

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approximately 78% of our funeral revenues are generated from at-need sales, we retain significant pricing leverage in our funeral business without having to rely on preneed sales.

Integrated Information Systems. We have implemented information systems to support local business decisions and to monitor performance of our businesses compared to financial and performance standards. All of our funeral homes and cemeteries are connected to our corporate headquarters, which allows us to monitor and assess critical operating and financial data and analyze the performance of individual locations on a timely basis. Furthermore, our information system infrastructure provides senior management with a critical tool for monitoring and adhering to our established internal controls, which is critical given our decentralized model and the sensitive nature of our business operations.

Proven Leadership Team. Our leadership team is comprised of eight members, which we refer to as our Operations and Strategic Growth Leadership Team ("OSGLT"), headed by our founder, Chairman and Chief Executive Officer, Melvin C. Payne and seven leaders of our support functions and is characterized by a dynamic culture that focuses on addressing changing market conditions and emerging trends in the funeral services industry. We believe our culture of emphasizing the 4Es (Energy, Energize Others, Edge and Execution) leadership characteristics is critical and will provide an important advantage as the funeral and cemetery industry evolves. We are committed to continue operating an efficient organization and strengthening our corporate and local business leadership. Our businesses are led by a Regional Partner who is a member of the OSGLT. This promotes more cooperation and synergy between our funeral and cemetery operations and supports the goal of market-share and volume growth in our most significant markets.

OPERATIONS

We conduct our funeral and cemetery operations only in the United States. Our operations are reported in two segments: funeral operations and cemetery operations. Information for each of our segments is presented below and in our financial statements set forth herein.

Funeral Home Operations

At December 31, 2016, we operated 170 funeral homes in 28 states. Funeral home revenues currently account for approximately 76% of our total revenues. The funeral home operations are managed by a team of experienced funeral and cemetery industry professionals and regional leadership with substantial management experience in our industry. See Part II, Item 8, Financial Statements and Supplementary Data, Note 20 for segment data related to our funeral home operations.

Our funeral homes offer a complete range of services to meet a family's deathcare needs, including consultation, the removal and preparation of remains, the sale of caskets and related funeral merchandise, the use of funeral home facilities for visitation and services and transportation services. Most of our funeral homes have a non-denominational chapel on the premises, which permits family visitation and services to take place at one location and thereby reduces transportation costs and inconvenience to the family.

Funeral homes are principally service businesses that provide burial and cremation services and sell related merchandise, such as caskets and urns. The sources and availability of caskets and urns are from a small number of national providers that have distribution centers near our businesses. We typically order and receive the merchandise within 24 hours. Given the high fixed-cost structure associated with funeral home operations, we believe the following are key factors affecting our profitability:

- our ability to establish and maintain market share positions supported by strong local heritage and relationships;
- our ability to effectively respond to the increasing trends towards cremation packaging complimentary services and merchandise;
- our ability to control salary, merchandise and other controllable costs;
- our ability to exercise pricing leverage related to our at-need business to increase average revenues per contract; and
- demographic trends in terms of population growth and average age, which impact death rates and number of deaths; and
- our response to fluctuations in capital markets and interest rates, which affect investment earnings on trust funds and our securities portfolio within the trust funds, which would offset lower pricing power as preneed contracts mature.

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Cemetery Operations

At December 31, 2016, we operated 32 cemeteries in 11 states. Cemetery revenues currently account for approximately 24% of our total revenues. The cemetery operations are managed by a team of experienced funeral and cemetery industry and sales professionals and regional leadership with substantial management experience in our industry. See Part II, Item 8, Financial Statements and Supplementary Data, Note 20 for segment data related to our cemetery operations.

Our cemetery products and services include interment services, the rights to interment in cemetery sites (primarily grave sites, mausoleum crypts and niches) and related cemetery merchandise, such as memorials and vaults. Cemetery operations generate revenues through sales of interment rights and memorials, installation fees, fees for interment and cremation memorialization products, finance charges from installment sales contracts and investment income from preneed cemetery merchandise trusts and perpetual care trusts. Cemetery revenues generated from at-need services and merchandise sales generally are subject to many of the same key profitability factors as our funeral home business. Our cemetery operating results are affected by the following key factors:

- size and success of our sales organization;
- local perceptions and heritage of our cemeteries;
- our ability to adapt to changes in the economy and consumer confidence; and
- our response to fluctuations in capital markets and interest rates, which affect investment earnings on trust funds, finance charges on installment contracts and our securities portfolio within the trust funds.

Preneed Programs

We market funeral and cemetery services and products on a preneed basis at the local level. Preneed funeral or cemetery contracts enable families to establish, in advance, the type of service to be performed, the products to be used and the cost of such products and services. Preneed contracts permit families to eliminate issues of making deathcare plans at the time of need and allow input from other family members before the death occurs. We guarantee the price and performance of the preneed contracts to the customer.

Preneed funeral contracts are usually paid on an installment basis. The performance of preneed funeral contracts is usually secured by placing the funds collected in trust for the benefit of the customer or by the customer's purchase of a life insurance policy, the proceeds of which will pay for such services at the time of need. These methods are intended to fund preneed funeral contracts, cover the original contract price and generally include an element of growth (earnings) designed to offset future inflationary cost increases. Revenue from preneed funeral contracts, along with accumulated earnings, is not recognized until the time the funeral service is performed. The accumulated earnings from the trust investments and insurance policies are intended to offset the inflation in funeral prices. Additionally, we generally earn a commission from the insurance company from the sale of insurance-funded policies reflected in our Consolidated Financial Statements as Preneed funeral insurance commission within Revenues: Funeral. The commission income is recognized as revenue when the period of refund expires (generally one year), which helps us defray the costs we incur to originate the preneed contract (primarily commissions we pay to our sales counselors).

In addition to preneed funeral contracts, we also offer “pre-planned” funeral arrangements whereby a customer determines in advance substantially all of the details of a funeral service without any financial commitment or other obligation on the part of the client until the actual time of need. Pre-planned funeral arrangements permit a family to avoid issues of making deathcare plans at the time of need and enable a funeral home to establish relationships with a client that may eventually lead to an at-need sale.

Preneed sales of cemetery interment rights are usually financed through interest-bearing installment sales contracts, generally with terms of up to five years with such earnings reflected in our Consolidated Financial Statements as Preneed cemetery finance charges within Revenues: Cemetery. In substantially all cases, we receive an initial down payment at the time the contract is signed. Preneed sales of cemetery interment rights are recorded as revenue when 10% of the contract amount related to the interment right has been collected. Cemetery merchandise and services may similarly be sold on an installment basis, but revenue is recorded when delivery has occurred. Allowances for bad debts and customer cancellations are recorded at the date that the contract is executed and periodically evaluated thereafter based upon historical experience.

We sold 7,797 and 7,639 preneed funeral contracts, net of cancellations, during the years ended December 31, 2015 and 2016, respectively. At December 31, 2016, we had a backlog of 91,402 preneed funeral contracts and 63,254 preneed cemetery contracts to be delivered in the future. Approximately 19% of our funeral contract volumes during the years ended December 31, 2015 and 2016 originated through preneed contracts. Cemetery revenues that originated from preneed contracts represented approximately 50% of our net cemetery revenues for 2015 and 2016.

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At December 31, 2016, we employed a staff of 210 advance-planning and family service representatives for the sale of preneed products and services. Our advance-planning and family service representatives primarily assist families in making at-need and pre-need funeral, memorialization and cemetery arrangements through the selection and purchase of cemetery property, merchandise and services and ensuring that the expectations of our client families and their guests are exceeded.

Trust Funds and Insurance Contracts

We have established a variety of trusts in connection with funeral home and cemetery operations as required under applicable state laws. Such trusts include (i) preneed funeral trusts; (ii) preneed cemetery merchandise and service trusts; and (iii) cemetery perpetual care trusts. These trusts are typically administered by independent financial institutions selected by us. Investment management and advisory services are provided either by our wholly-owned registered investment advisory firm, CSV RIA, or by independent financial advisors. At December 31, 2016, CSV RIA provided these services to two institutions, which have custody of 79% 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 as the advisory services are provided. The investment advisors establish an investment policy that gives guidance on asset allocation, investment requirements, investment manager selection and performance monitoring. The investment objectives are tailored to generate long-term investment returns without assuming undue risk, while ensuring the management of assets is in compliance with applicable laws.

Preneed funeral sales generally require deposits to a trust or purchase of a third-party insurance product. Trust fund income earned, along with the receipt and recognition of any insurance benefits, are deferred until the service is performed or the merchandise is delivered. Trust fund holdings and deferred revenue are reflected on our Consolidated Balance Sheets, while the insurance contracts are not on our Consolidated Balance Sheets. In most states, we are not permitted to withdraw principal or investment income from such trusts until the funeral service is performed. Some states, however, allow for the retention of a percentage (generally 10%) of the receipts to offset any administrative and selling expenses. The aggregate balance of our preneed funeral contracts held in trust, insurance contracts and receivables from preneed trusts was approximately $460.9 million as of December 31, 2016.

We are generally required under applicable state laws to deposit a specified amount (which varies from state to state, generally 50% to 100% of the selling price) into a merchandise and service trust fund for preneed cemetery merchandise and services sales. The related trust fund income earned is recognized when the related merchandise and services are delivered. We are generally permitted to withdraw the trust principal and accrued income when the merchandise is actually delivered, when the service is provided or when the contract is canceled. However, certain states allow the withdrawal of income prior to delivery when the regulations identify excess earnings in the trusts. We did not withdraw any trust income in 2015 and 2016. Cemetery merchandise and service trust fund balances totaled approximately $69.7 million as of December 31, 2016.

In most states, regulations require a portion (generally 10%) of the sale amount of cemetery property and memorials to be placed in a perpetual care trust. The income from these perpetual care trusts provides funds necessary to maintain cemetery property and memorials in perpetuity. This trust fund income is recognized, as earned and is reflected in our Consolidated Financial Statements as Revenues: Cemetery. While we are entitled to withdraw the income from perpetual care trusts to provide for maintenance of cemetery property and memorials, we are restricted from withdrawing any of the principal balances of the trust fund. Perpetual care trust balances totaled approximately $46.9 million at December 31, 2016.

For additional information with respect to our trusts, see Part II, Item 8, Financial Statements and Supplementary Data, Notes 6, 8 and 10.

SEASONALITY

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

COMPETITION

The operating environment in the funeral and cemetery industry has been highly competitive. Publicly traded companies operating in the United States include SCI, StoneMor and Carriage. In addition, a number of smaller private consolidators have been active in acquiring and operating funeral homes and cemeteries.

Our funeral home and cemetery operations face competition in the markets that they serve. Our primary competition in most of our markets is from local independent operators. We have observed new start-up competition in certain areas of the country, which may impact our profitability in certain markets, because of the high fixed cost nature of our funeral home operations. Market share for funeral homes and cemeteries is largely a function of reputation and heritage, although competitive pricing, professional service and attractive, well-maintained and conveniently located facilities are also important. Because of the importance of

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reputation and heritage, market share increases are usually gained over a long period of time. The sale of preneed funeral services and cemetery property has increasingly been used by many companies as a marketing tool to build market share.

There has been increasing competition from providers specializing in specific services, such as cremations, who offer minimal service and low-end pricing. We also face competition from companies that market products and related merchandise over the internet and non-traditional casket stores in certain markets. These competitors have been successful in capturing a portion of the low-end market and product sales.

REGULATION

General. Our operations are subject to regulations, supervision and licensing under numerous federal, state and local laws, ordinances and regulations, including extensive regulations concerning trust funds, preneed sales of funeral and cemetery products and services and various other aspects of our business. We believe that we comply in all material respects with the provisions of these laws, ordinances and regulations.

Federal Trade Commission. Our funeral home operations are comprehensively regulated by the Federal Trade Commission (“FTC”) under Section 5 of the Federal Trade Commission Act and a trade regulation rule for the funeral industry promulgated thereunder referred to as the “Funeral Rule.” The Funeral Rule defines certain acts or practices as unfair or deceptive and contains certain requirements to prevent these acts or practices. The preventive measures require a funeral provider to give consumers accurate, itemized pricing information and various other disclosures about funeral goods and services and prohibit a funeral provider from: (i) misrepresenting legal, crematory and cemetery requirements; (ii) embalming for a fee without permission; (iii) requiring the purchase of a casket for direct cremation; (iv) requiring consumers to buy certain funeral goods or services as condition for furnishing other funeral goods or services; (v) misrepresenting state and local requirements for an outer burial container; and (vi) representing that funeral goods and services have preservative and protective value. Additionally, the Funeral Rule requires the disclosure of mark-ups, commissions, additional charges and rebates related to cash advance items.

Environmental. Our operations are also subject to stringent federal, regional, state and local laws and regulations relating to environmental protection, including legal requirements governing air emissions, waste management and disposal and wastewater discharges. For instance, the federal Clean Air Act and analogous state laws, which restrict the emission of pollutants from many sources, including crematories, may require us to apply for and obtain air emissions permits, install costly emissions control equipment, and conduct monitoring and reporting tasks. Also, in the course of our operations, we store and use chemicals and other regulated substances as well as generate wastes that may subject us to strict liability under the federal Resource Conservation and Recovery Act and comparable state laws, which govern the treatment, storage, and disposal of nonhazardous and hazardous wastes, and the federal Comprehensive Environmental Response, Compensation and Liability Act, a remedial statute that imposes cleanup obligations on current and past owners or operators of facilities where hazardous substance releases occurred and anyone who transported or disposed or arranged for the transportation or disposal of hazardous substances released into the environment from such sites. In addition, the Federal Water Pollution Control Act, also known as the federal Clean Water Act, and analogous state laws regulate discharges of pollutants to state and federal waters. Underground and aboveground storage tanks that store chemicals and fuels for vehicle maintenance or general operations are located at certain of our facilities and any spills or releases from those facilities may cause us to incur remedial liabilities under the Clean Water Act or analogous state laws as well as potential liabilities for damages to properties or persons. Failure to comply with environmental laws and regulations could result in the assessment of sanctions, including administrative, civil, and criminal penalties, the imposition of investigatory, remedial and corrective action obligations, delays in permitting or performance of projects and the issuance of injunctions restricting or prohibiting some or all of our activities in affected areas. Moreover, accidental releases or spills may occur in the course of our operations, and we cannot assure you that we will not incur significant costs and liabilities as a result of such releases or spills, including any third party claims for damages to property, natural resources or persons. Also, it is possible that implementation of stricter environmental laws and regulations or more stringent enforcement of existing environmental requirements could result in additional, currently unidentifiable costs or liabilities to us, such as requirements to purchase pollution control equipment or implement operational changes or improvements. While we believe we are in substantial compliance with existing environmental laws and regulations, we cannot assure you that

we will not incur substantial costs in the future.
Worker Health and Safety. We are subject to the requirements of the federal Occupational Safety and Health Act, as amended ("OSHA"), and comparable state statutes whose purpose is to protect the health and safety of workers. In addition, the OSHA hazard communication standard, the Emergency Planning and Community Right to Know Act and implementing regulations and similar state statutes and regulations require that we organize and/or disclose information about hazardous materials used or produced in our operations and that this information be provided to employees, state and local governmental authorities and citizens. We believe that we are in substantial compliance with all applicable laws and regulations relating to worker health and safety.

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EMPLOYEES

As of December 31, 2016, we and our subsidiaries employed 2,509 employees, of whom 1094 were full-time and 1,415 were part-time. All of our funeral directors and embalmers possess licenses required by applicable regulatory agencies. None of our employees are represented by unions.

AVAILABLE INFORMATION

We file annual, quarterly and other reports, and any amendments to those reports, and information with the United States Securities and Exchange Commission (“SEC”). You may read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. You may obtain additional information about the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including us.

Our website address is www.carriageservices.com. Available on this website under “Investors – SEC Filings,” free of charge, are Carriage’s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, insider reports on Forms 3, 4 and 5 filed on behalf of directors and officers and amendments to those reports as soon as reasonably practicable after such materials are electronically filed with or furnished to the SEC.

Also posted on our website, and available in print upon request, are charters for our Audit Committee, Compensation Committee and Corporate Governance Committee. Copies of the Code of Business Conduct and Ethics and the Corporate Governance Guidelines are also posted on our website under “Investors – Corporate Governance.” Within the time period required by the SEC and the New York Stock Exchange, we will post on our website any modifications to the charters and any waivers applicable to senior officers as defined in the applicable charters, as required by the Sarbanes-Oxley Act of 2002.

ITEM 1A. RISK FACTORS

RISKS RELATED TO OUR BUSINESS

The success of our businesses is typically dependent upon one or a few key employees for success because of the localized and personal nature of our business.

Funeral home and cemetery businesses have built local heritage and tradition through successive generations, providing a foundation for ongoing business opportunities from established client family relationships and related referrals. We believe these relationships build trust in the community and are a key driver to market share. Our businesses, which tend to serve small local markets, usually have one or a few key employees that drive our relationships. Our ability to attract and retain Managing Partners, sales force and other personnel is an important factor in achieving future success. We can give no assurance that we can retain these employees or that these relationships will drive market share. Our inability to attract and maintain qualified and productive Managing Partners and sales force could have a material adverse effect on our financial condition, results of operations and cash flows.

Our ability to execute our growth strategy is highly dependent upon our ability to successfully identify suitable acquisition candidates and negotiate transactions on favorable terms.

Our growth strategy is the primary way we expect to increase stockholder value. There is no assurance that we will be able to continue to identify acquisition candidates that meet our criteria or that we will be able to reach terms with identified candidates for transactions that are acceptable to us, and even if we do, we may not be able to successfully complete the transaction or integrate the new business into our existing business. We intend to apply standards established under our Strategic Acquisition Model to evaluate acquisition candidates, and there is no assurance that we will continue to be successful in doing so or that we will find attractive candidates that satisfy these standards. Due in part to the presence of competitors who have been in certain markets longer than we have, such acquisitions or investments may be more difficult or expensive than we anticipate.

Marketing and sales activities by existing and new competitors could cause us to lose market share and lead to lower revenues and margins.

We face competition in all of our markets. Most of our competitors are independently owned, and some are relatively recent market entrants. Some of the recent entrants are individuals who were formerly employed by us or by our competitors and have relationships and name recognition within our markets. As a group, independent competitors tend to be aggressive in distinguishing themselves by their independent ownership, and they promote their independence through television, radio and print advertising, direct mailings and personal contact. Increasing pressures from new market entrants and continued advertising and marketing by competitors in local markets could cause us to lose market share and revenues. In addition, competitors may change the types or mix of products or services offered. These changes may attract customers, causing us to lose market share and revenue as well as

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to incur costs in response to competition to vary the types or mix of products or services offered by us. Also, increased use of the internet by customers to research and/or purchase products and services could cause us to lose potential revenue.

Improved performance in our funeral and cemetery segments is dependent upon successful execution of our Standards Operating Model.

We have implemented our Standards Operating Model to improve and better measure performance in our funeral and cemetery operations. We developed standards according to criteria, each with a different weighting, designed around market share, people and operational and financial metrics. We also incentivize our location Managing Partners by giving them the opportunity to earn a fixed percentage of the field-level earnings before interest, taxes, depreciation and amortization based upon the number and weighting of the standards achieved. Our expectation is that, over time, the Standards Operating Model will result in improving field-level margins, market share, customer satisfaction and overall financial performance, but there is no assurance that these goals will be met. Failure to successfully implement our Standards Operating Model in our funeral and cemetery operations could have a material adverse effect on our financial condition, results of operations and cash flows.

Our “Good to Great” incentive program could result in significant future payments to our Managing Partners.

In January, 2012, in order to continue to align our Managing Partners' incentives with the long-term interests of our stockholders, we implemented our “Good to Great” incentive program, which rewards our Managing Partners for achieving an average net revenue compounded annual growth rate equal to at least 2% (the “Minimum Growth Rate”) over a five-year performance period (the “Performance Period”) with respect to our funeral homes that they operate. The initial Performance Period commenced on January 1, 2012 and ended on December 31, 2016. The Performance Periods for new Managing Partners commences each year after 2012. Each Managing Partner that achieves the Minimum Growth Rate during the applicable Performance Period and remains continuously employed as a Managing Partner of the same business throughout the Performance Period will receive a one-time bonus, payable in a combination of cash and shares our common stock, determined at our discretion. We believe this incentive program will result in improved field-level margins, market share and overall financial performance. For the first five-year performance period which ended December 31, 2016, we will payout approximately $2.4 million to 12 Managing Partners who earned a bonus under this program. Their combined annual growth rate in Revenue and Field Level Operating Earnings was 4.9% and 10%, respectively.

Price competition could also reduce our market share or cause us to reduce prices to retain or recapture market share, either of which could reduce revenues and margins.

We have historically experienced price competition primarily from independent funeral home and cemetery operators, and from monument dealers, casket retailers, low-cost funeral providers and other non-traditional providers of services or products. New market entrants tend to attempt to build market share by offering lower cost alternatives. In the past, this price competition has resulted in our losing market share in some markets. In other markets, we have had to reduce prices or offer discounts thereby reducing profit margins in order to retain or recapture market share. Increased price competition in the future could further reduce revenues, profits and our preneed backlog.

Our ability to generate preneed sales depends on a number of factors, including sales incentives and local and general economic conditions.

Significant declines in preneed sales would reduce our backlog and revenue and could reduce our future market share. On the other hand, a significant increase in preneed sales can have a negative impact on cash flow as a result of commissions and other costs incurred initially without corresponding revenues.

As we have localized our preneed sales strategies, we are continuing to refine the mix of service and product offerings in both our funeral and cemetery segments, including changes in our sales commission and incentive structure. These changes could cause us to experience declines in preneed sales in the short-run. In addition, economic conditions at the local or national level could cause declines in preneed sales either as a result of less discretionary income or lower consumer confidence. Declines in preneed cemetery property sales reduces current revenue, and declines in other preneed sales would reduce our backlog and future revenue and could reduce future market share.

Increased preneed sales could have a negative impact on our cash flows.

Preneed sales of funeral and cemetery products and services generally have an initial negative impact on our cash flows, as we are required to deposit a portion of the sales proceeds into trusts or escrow accounts and often incur other expenses at the time of sale. Furthermore, many preneed purchases are paid for in installments over a period of several years, further reducing our cash flows at the time of sale. Because preneed sales generally provide positive cash flows over the long term, we market the sale of such contracts at the local level. If our efforts to increase such sales are successful, however, our current cash flows could be materially and adversely affected.

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Our funeral and cemetery trust funds own investments in equity securities, fixed income securities, and mutual funds, which are affected by market conditions that are beyond our control.

In connection with our backlog of preneed funeral and preneed cemetery merchandise and service contracts, funeral and cemetery trust funds own investments in equity securities, fixed income securities and mutual funds. Our returns on these investments are affected by financial market conditions that are beyond our control.

The following table summarizes our investment returns (realized and unrealized), excluding certain fees, on our trust funds for the years ended December 31, 2014, 2015 and 2016:

	2014	2015	2016
Preneed funeral trust funds	7.4%	(2.2)%	17.0%
Preneed cemetery trust funds	8.3%	(3.0)%	19.6%
Perpetual care trust funds	8.4%	(3.3)%	19.2%

Generally, earnings or gains and losses on our preneed funeral and cemetery trust investments are recognized, and we withdraw cash, when the underlying service is performed, merchandise is delivered, or upon contract cancellation. Our cemetery perpetual care trusts recognize earnings, and in certain states, capital gains and losses, and we withdraw cash when we incur qualifying cemetery maintenance costs. If the investments in our trust funds experience significant, recurring and sustained declines in subsequent years, there could be insufficient funds in the trusts to cover the costs of delivering services and merchandise or maintaining cemeteries in the future. We may be required to cover any such shortfall with cash flows from operations, which could have a material adverse effect on our financial condition, results of operations or cash flows. For more information related to our trust investments, see Part II, Item 8, Financial Statements and Supplementary Data, Notes 6 and 10.

If the fair market value of these trusts, plus any other amount due to us upon delivery of the associated contracts, were to decline below the estimated costs to deliver the underlying products and services, we would record a charge to earnings to record a liability for the expected losses on the delivery of the associated contracts. As of December 31, 2016, no such charge was required. For additional information, see Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, Critical Accounting Policies and Estimates.

Earnings from and principal of trust funds could be reduced by changes in financial markets and the mix of securities owned.

Earnings and investment gains and losses on trust funds are affected by financial market conditions and the specific fixed-income and equity securities that we choose to maintain in the funds. We may not choose the optimal mix for any particular market condition. Declines in earnings from perpetual care trust funds would cause a decline in current revenues, while declines in earnings from other trust funds could cause a decline in future cash flows and revenues.

We may be required to replenish our funeral and cemetery trust funds in order to meet minimum funding requirements, which would have a negative effect on our earnings and cash flow.

In certain states, we have withdrawn allowable distributable earnings including gains prior to the maturity or cancellation of the related contract. Additionally, some states have laws that either require replenishment of investment losses under certain circumstances or impose various restrictions on withdrawals of future earnings when trust fund values drop below certain prescribed amounts. In the event of realized losses or market declines, we may be required to deposit portions or all of these amounts into the respective trusts in some future period.

Increasing death benefits related to preneed funeral contracts funded through life insurance contracts may not cover future increases in the cost of providing a price-guaranteed funeral service.

We sell price-guaranteed preneed funeral contracts through various programs providing for future funeral services at prices prevailing when the agreements are signed. For preneed funeral contracts funded through life insurance contracts, we receive in cash a general agency commission from the third-party insurance company. Additionally, there is an increasing death benefit associated with the contract that may vary over the contract life. There is no guarantee that the increasing death benefit will cover future increases in the cost of providing a price-guaranteed funeral service, and any such excess cost could be materially adverse to our future cash flows, revenues, and operating margins.

The financial condition of third-party insurance companies that fund our preneed funeral contracts may impact our future revenues.

Where permitted by state law, our customers may arrange their preneed funeral contract by purchasing a life insurance policy from third-party insurance companies. The customer/policy holder assigns the policy benefits to our funeral home to pay for the preneed funeral contract at the time of need. If the financial condition of the third-party insurance companies were to deteriorate

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materially because of market conditions or otherwise, there could be an adverse effect on our ability to collect all or part of the proceeds of the life insurance policy, including the annual increase in the death benefit, when we fulfill the preneed contract at the time of need. Failure to collect such proceeds could have a material adverse effect on our financial condition, results of operations, or cash flows.

Increased or unanticipated costs, such as insurance or taxes, may have a negative impact on our earnings and cash flow.

We may experience material increases in certain costs, such as insurance or taxes. Future cost increases are difficult to quantify and could materially and adversely affect our results of operations and cash flows.

New or revised tax regulations could have a material effect on our financial results.

The tax environment in which we operate is evolving rapidly with the enactment, or the proposal to enact, sweeping corporate tax legislative changes. Changes in tax laws or tax rates under the new administration may have a positive or negative impact on earnings and cash flow. Significant judgment is required in determining the impact of potential legislative changes on our provision for income taxes. While we expect that the currently proposed legislative changes would have a beneficial impact on earnings and cash flows, the final and enacted legislation could result in a different outcome.

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

The terms of our Credit Agreement and the Convertible Notes may limit our ability and the ability of our subsidiaries to, among other things: incur additional debt; pay dividends or make distributions or redeem or repurchase stock; make investments; grant liens; make capital expenditures; enter into transactions with affiliates; enter into sale-leaseback transactions; sell assets; and acquire the assets of, or merge or consolidate with, other companies.

Our Credit Agreement also requires us to maintain certain financial ratios. Complying with these restrictive covenants and financial ratios, as well as those that may be contained in any future debt agreements, may limit our ability to finance our future operations or capital needs or to take advantage of other favorable business opportunities. Our ability to comply with these restrictive covenants and financial ratios will depend on our future performance, which may be affected by events beyond our control. Our failure to comply with any of these covenants or restrictions when they apply could result in a default under any future debt instrument, which could result in acceleration of the debt under that instrument and, in some cases, the acceleration of debt under other instruments that contain cross-default or cross-acceleration provisions. In the case of an event of default, or in the event of a cross-default or cross-acceleration, we may not have sufficient funds available to make the required payments under our debt instruments. If we are unable to repay amounts owed under the terms of our Credit Agreement, the lenders thereunder may be entitled to sell certain of our funeral assets to satisfy our obligations under the agreement.

Economic, financial and stock market fluctuations could affect future potential earnings and cash flows and could result in future goodwill, intangible assets and long-lived asset impairments.

In addition to an annual review, we assess the impairment of goodwill, intangible assets and other long-lived assets whenever events or changes in circumstances indicate that the carrying value may be greater than fair value. Factors that could trigger an interim impairment review include, but are not limited to, a significant decline in the market value of our stock or debt values, significant under-performance relative to historical or projected future operating results, and significant negative industry or economic trends. If these factors occur, we may have a triggering event, which could result in an impairment of our goodwill. Based on the results of our annual goodwill and intangible assets impairment test we performed as of August 31, 2016 and our annual review of long-lived assets as of December 31, 2016, we concluded that there was no impairment of our goodwill, intangible assets or other long-lived assets. However, if current economic conditions weaken causing deterioration in our operating revenues, operating margins and cash flows, we may have a triggering event that could result in a material impairment of our goodwill, intangible assets and/or long-lived assets.

We rely significantly on information technology and any failure, inadequacy, interruption or security lapse of that technology, including any cybersecurity incidents, could harm our ability to operate our business effectively.

In the ordinary course of our business, we receive certain personal information, in both physical and electronic formats, about our customers, their loved ones, our associates, and our vendors. We maintain substantial security measures and data backup systems to protect, store, and prevent unauthorized access to such information.

Nevertheless, it is possible that computer hackers and others (through cyberattacks, which are rapidly evolving and becoming increasingly sophisticated, or by other means) might defeat our security measures in the future and obtain the personal information of customers, their loved ones, our associates, and our vendors that we hold. If we fail to protect our own information, we could experience significant costs and expenses as well as damage to our reputation. Our ability to manage and maintain our internal reports effectively and integration of new business acquisitions depends significantly on our enterprise resource planning system and other information systems. Some of our information technology systems may experience interruptions, delays or cessations of service or produce errors in connection with ongoing systems

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implementation work. The failure of our systems to operate effectively or to integrate with other systems, or a breach in security or other unauthorized access of these systems, may also result in reduced efficiency of our operations and could require significant capital investments to remediate any such failure, problem or breach and to comply with applicable regulations, all of which could adversely affect our business, financial condition and results of operations.

RISKS RELATED TO THE FUNERAL AND CEMETERY INDUSTRY

Declines in the number of deaths in our markets can cause a decrease in revenues. Changes in the number of deaths are not predictable from market to market or over the short term.

Declines in the number of deaths could cause at-need sales of funeral and cemetery services, property and merchandise to decline, which could decrease revenues. Although the United States Bureau of the Census estimates that the number of deaths in the United States will increase in the future, longer life spans could reduce the rate of deaths. In addition, changes in the number of deaths can vary among local markets and from quarter to quarter, and variations in the number of deaths in our markets or from quarter to quarter are not predictable. These variations may cause our revenues to fluctuate and our results of operations to lack predictability.

The increasing number of cremations in the United States could cause revenues to decline because we could lose market share to firms specializing in cremations. In addition, direct cremations produce minimal revenues for cemetery operations and lower funeral revenues.

Our traditional cemetery and funeral service operations face competition from the increasing number of cremations in the United States. Industry studies indicate that the percentage of cremations has increased every year and this trend is expected to continue into the future. The trend toward cremation could cause cemeteries and traditional funeral homes to lose market share and revenues to firms specializing in cremations. In addition, direct cremations (with no funeral service, casket, urn, mausoleum niche, columbarium niche or burial) produce no revenues for cemetery operations and lower revenues than traditional funerals and, when delivered at a traditional funeral home, produce lower profits as well.

If we are not able to respond effectively to changing consumer preferences, our market share, revenues and profitability could decrease.

Future market share, revenues and profits will depend in part on our ability to anticipate, identify and respond to changing consumer preferences. In past years, we have implemented new product and service strategies based on results of customer surveys that we conduct on a continuous basis. However, we may not correctly anticipate or identify trends in consumer preferences, or we may identify them later than our competitors do. In addition, any strategies we may implement to address these trends may prove incorrect or ineffective.

Because the funeral and cemetery businesses are high fixed-cost businesses, changes in revenue can have a disproportionately large effect on cash flow and profits.

Companies in the funeral home and cemetery business must incur many of the costs of operating and maintaining facilities, land and equipment regardless of the level of sales in any given period. For example, we must pay salaries, utilities, property taxes and maintenance costs on funeral homes and maintain the grounds of cemeteries regardless of the number of funeral services or interments performed. Because we cannot decrease these costs significantly or rapidly when we experience declines in sales, declines in sales can cause margins, profits and cash flow to decline at a greater rate than the decline in revenues.

Changes or increases in, or failure to comply with, regulations applicable to our business could increase costs or decrease cash flows.

The funeral and cemetery industry is subject to extensive and evolving regulation and licensing requirements under federal, state and local laws. For example, the funeral home industry is regulated by the FTC, which requires funeral homes to take actions designed to protect consumers. State laws impose licensing requirements and regulate preneed sales. As such, we are subject to state trust fund and preneed sales practice audits, which could result in audit adjustments as a result of non-compliance. In addition, we assume the liability for any audit adjustments for our acquired businesses for periods under audit that were prior to our ownership of the business. These audit adjustments could have a material adverse impact on our financial condition, results of operations and cash flows.

Embalming and cremation facilities are subject to stringent environmental and health regulations. Compliance with these regulations is burdensome, and we are always at risk of not complying with the regulations or facing costly and burdensome investigations from regulatory authorities.

In addition, from time to time, governments and agencies propose to amend or add regulations, which could increase costs or decrease cash flows. Several states and regulatory agencies have considered or are considering regulations that could require more liberal refund and cancellation policies for preneed sales of products and services, limit or eliminate our ability to use surety bonding, increase trust requirements and/or prohibit the common ownership of funeral homes and cemeteries in the same market. If adopted by the regulatory authorities of the jurisdictions in which we operate, these and other possible proposals could have a material adverse effect on us, our financial condition, our results of operations and our future prospects. For additional information regarding the regulation of the funeral and cemetery industry, see Part I, Item 1, Business, Regulation.

We are subject to environmental and worker health and safety laws and regulations that may expose us to significant costs and liabilities.

Our cemetery and funeral home operations are subject to stringent federal, regional, state and local laws and regulations governing worker health and safety aspects of the operations, the release or disposal of materials into the environment or otherwise relating to environmental protection. These laws and regulations may restrict or impact our business in many ways, including requiring the acquisition of a permit before conducting regulated activities, restricting the types, quantities and concentration of substances that can be released into the environment, applying specific health and safety criteria addressing worker protection, and imposing substantial liabilities for any pollution resulting from our operations. We may be required to make significant capital and operating expenditures to comply with these laws and regulations and any failure to comply may result in the assessment of sanctions, including administrative, civil and criminal penalties, imposition of investigatory, remedial or corrective action obligations, delays in permitting or performance of projects and the issuance of injunctions restricting or prohibiting our activities. Failure to appropriately transport and dispose of generated wastes, used chemicals or other regulated substances, or any spills or other unauthorized releases of regulated substances in the course of our operations could expose us to material losses, expenditures and liabilities under applicable environmental laws and regulations, and result in neighboring landowners and other third parties filing claims for personal injury, property damage and natural resource damage allegedly caused by such non-compliant activities or spills or releases. Certain of these laws may impose strict, joint and several liabilities upon us for the remediation of contaminated property resulting from our or a predecessor owner's or operator's operations. We may not be able to recover some or any of these costs from insurance or contractual indemnifications. Moreover, changes in environmental laws, regulations and enforcement policies occur frequently, and any changes that result in more stringent or costly emissions control or waste handling, storage, transport, disposal or cleanup requirements could require us to make significant expenditures to attain and maintain compliance and may otherwise have a material adverse effect on our results of operations, competitive position or financial condition.

Burial practice claims could have a material adverse impact on our financial results.

From time to time, we are party to various claims and legal proceedings, including burial practices. When cemetery disputes occur, we may be subjected to litigation and liability for improper burial practices. In addition, since we acquired most of our cemeteries through various acquisitions, we may be subject to litigation and liability based upon actions or events that occurred before we acquired or managed the cemeteries. Claims or litigation based upon our cemetery burial practices could have a material adverse impact on our financial condition, results of operations and cash flows.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

At December 31, 2016, we operated 170 funeral homes in 28 states and 32 cemeteries in 11 states. We own the real estate and buildings for 148 of our funeral homes and lease 22 facilities. We own 28 cemeteries and operate four cemeteries under long-term contracts with municipalities and non-profit organizations, which we refer to as managed properties. We operate 13 funeral homes in combination with cemeteries as these locations are physically located on the same property or in very close proximity and are under the same leadership.

The 32 cemeteries, operated by us have an inventory of unsold developed lots totaling approximately 142,725 and 144,068 at December 31, 2015 and 2016, respectively. In addition, we own approximately 456 acres that are available for future development or sale. We anticipate having a sufficient inventory of lots to maintain our property sales for the foreseeable future.

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The following table sets forth certain information as of December 31, 2016, regarding our properties used by the funeral home segment and by the cemetery segment identified by state:

	Number of Funeral Homes		Number of Cemeteries	
State	Owned	Leased[(1)]	Owned	Managed
California	23	5	4	—
Connecticut	8	2	—	—
Florida	11	5	5	3
Georgia	4	—	—	—
Idaho	5	1	3	—
Illinois	2	1	1	—
Kansas	2	—	—	—
Kentucky	9	1	1	—
Louisiana	3	1	1	—
Maryland	1	—	—	—
Massachusetts	12	—	—	—
Michigan	2	—	—	—
Montana	2	1	1	—
Nevada	2	—	2	1
New Jersey	4	1	—	—
New Mexico	1	—	—	—
New York	2	—	—	—
North Carolina	6	1	1	—
Ohio	4	—	—	—
Oklahoma	6	—	2	—
Pennsylvania	1	—	—	—
Rhode Island	4	—	—	—
Tennessee	4	—	—	—
Texas	21	1	7	—
Virginia	5	1	—	—
Washington	2	—	—	—
West Virginia	1	1	—	—
Wisconsin	1	—	—	—
Total	148	22	28	4

(1) The leases, with respect to these funeral homes, generally have remaining terms ranging from one

to ten years, and generally, we have the right to renew past the initial terms and have a right of first refusal on any proposed sale of the property where these funeral homes are located.

Our corporate headquarters occupy approximately 48,000 square feet of leased office space in Houston, Texas. At December 31, 2016, we owned and operated 881 vehicles and leased 2 vehicles.

ITEM 3. LEGAL PROCEEDINGS.

We and our subsidiaries are parties to a number of legal proceedings that arise from time to time in the ordinary course of our business. While the outcome of these proceedings cannot be predicted with certainty, we do not expect these matters to have a material adverse effect on our financial statements. Information regarding litigation is set forth in Part II, Item 8, Financial Statements and Supplementary Data, Note 15.

We self-insure against certain risks and carry insurance with coverage and coverage limits for risks in excess of the coverage amounts consistent with our assessment of risks in our business and of an acceptable level of financial exposure. Although there can be no assurance that self-insurance reserves and insurance will be sufficient to mitigate all damages, claims or contingencies,

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we believe that the reserves and our insurance provide reasonable coverage for known asserted and unasserted claims. In the event we sustain a loss from a claim and the insurance carrier disputes coverage or coverage limits, we may record a charge in a different period than the recovery, if any, from the insurance carrier.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

MARKET INFORMATION

Our common stock is traded on the New York Stock Exchange under the symbol "CSV." The following table presents the quarterly high and low sale prices as reported by the New York Stock Exchange:

2016	High	Low
First Quarter	$23.85	$19.03
Second Quarter	$24.94	$21.25
Third Quarter	$24.97	$22.53
Fourth Quarter	$29.11	$23.06

2015	High	Low
First Quarter	$25.20	$19.41
Second Quarter	$25.65	$22.98
Third Quarter	$24.57	$20.03
Fourth Quarter	$25.96	$21.01

As of February 16, 2017, there were 16,660,755 shares of our common stock outstanding and the closing price as reported by the New York Stock Exchange was $26.82 per share. The shares of common stock outstanding are held by approximately 475 stockholders of record. Each share is entitled to one vote on matters requiring the vote of stockholders. We believe there are approximately 5,300 beneficial owners of our common stock.

DIVIDENDS

The following table sets fourth certain information with respect to the payment of cash dividends on our common stock:

2016	Per Share	Dollar Value
First Quarter	$0.025	$415,000
Second Quarter	$0.025	$415,000
Third Quarter	$0.050	$831,000
Fourth Quarter	$0.050	$830,000

2015	Per Share	Dollar Value
First Quarter	$0.025	$463,000
Second Quarter	$0.025	$462,000
Third Quarter	$0.025	$460,000
Fourth Quarter	$0.025	$434,000

While we intend to pay regular quarterly cash dividends for the foreseeable future, covenant restrictions under our Credit Agreement may limit our ability to pay dividends in the future.

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EQUITY PLANS

For information regarding securities authorized for issuance under our equity compensation plans, see Part III, Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

PURCHASES OF EQUITY SECURITIES BY THE ISSUER

On February 25, 2016, our Board approved a share repurchase program authorizing us to purchase up to an aggregate of $25.0 million of our common stock in accordance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended. The 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 year ended December 31, 2016, we did not repurchase any shares of common stock pursuant to this share repurchase program.

The following table sets fourth certain information with respect to repurchases of our common stock during the quarter ended December 31, 2016:

Period	Total Number of Shares Purchased[1]	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Dollar Value of Shares That May Yet Be Purchased Under the Program
October 1, 2016 - October 31, 2016	—	$ —	—	$ —
November 1, 2016 - November 30, 2016	—	$ —	—	$ —
December 1, 2016 - December 31, 2016	3,317	$ 27.79	—	$ —
Total for quarter ended December 31, 2016	3,317		—	

(1) Represents shares surrendered by an employee to pay the option exercise price with company stock that the option holder owns.

On May 19, 2015, 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 the Exchange Act. On September 28, 2015, our Board authorized additional repurchases of $20.0 million of our common stock bringing the total authorized repurchase amount to $45.0 million. During the year ended December 31, 2015, we purchased 1,927,665 shares of our common stock for a total cost of $45.0 million, representing the entire authorized repurchase amount, at an average cost of $23.34 per share.

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PERFORMANCE

The following graph compares the cumulative 5-year total return provided to shareholders on our common stock relative to the cumulative total returns of the Russell 3000 Index, and a customized peer group of two companies that includes SCI and StoneMor. The returns of each member of the peer group are weighted according to each member's stock market capitalization as of the beginning of each period measured. The graph assumes that the value of the investment in our common stock, the Russell 3000 Index and the peer group was $100 on the last trading day of December 2011, and that all dividends were reinvested. Performance data for Carriage, the Russell 3000 Index and the peer group is provided as of the last trading day of each of our last five fiscal years.

The following graph and related information shall not be deemed "soliciting material" or "filed" with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Carriage Services, Inc., the Russell 3000 Index and a Peer Group

*$100 invested on December 31, 2011 in stock or index, including reinvestment of dividends.
Fiscal year ending December 31. Peer Group includes SCI and StoneMor.

	12/11	12/12	12/13	12/14	12/15	12/16
Carriage Services, Inc.	$100.00	$218.16	$361.05	$389.43	$449.91	$538.09
Russell 3000	100.00	114.69	153.19	172.43	173.24	195.28
Peer Group	100.00	127.13	171.26	215.17	248.73	258.90

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

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ITEM 6. SELECTED FINANCIAL DATA.

The table on the following page sets forth selected consolidated financial information for us that has been derived from the audited Consolidated Financial Statements of the Company as of and for each of the years ended December 31, 2012, 2013, 2014, 2015 and 2016. These historical results are not indicative of our future performance. You should read this historical financial data together with “Management's Discussion and Analysis of Financial Condition and Results of Operations” included in this Form 10-K and our Consolidated Financial Statements and notes thereto included elsewhere in this Form 10-K.

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Selected Consolidated Financial Information

	Year ended December 31,				
	2012	2013	2014	2015	2016
	(dollars in thousands, except per share amounts)				
INCOME STATEMENT DATA:					
Revenues:					
Funeral	$150,803	$163,082	$173,735	$185,818	$189,401
Cemetery	47,388	49,992	52,389	56,684	58,799
Total revenues	198,191	213,074	226,124	242,502	248,200
Gross profit:					
Funeral	47,260	48,874	54,102	59,434	61,620
Cemetery	13,967	15,411	15,906	18,074	18,030
Total gross profit	61,227	64,285	70,008	77,508	79,650
General and administrative expenses	24,960	27,379	30,293	28,860	29,446
Operating income	36,267	36,906	39,715	48,648	50,204
Interest expense	(17,088)	(12,622)	(10,308)	(10,559)	(11,738)
Accretion of discount on convertible subordinated notes	—	—	(2,452)	(3,454)	(3,870)
Loss on early extinguishment of debt and other costs	(3,031)	—	(1,042)	—	(567)
Loss on redemption of convertible junior subordinated debentures	—	—	(3,779)	—	—
Other, net	963	81	567	(45)	(1,788)
Income before income taxes	17,111	24,365	22,701	34,590	32,241
Provision for income taxes, net	(6,794)	(9,245)	(7,255)	(13,737)	(12,660)
Net income from continuing operations	10,317	15,120	15,446	20,853	19,581
Income from discontinued operations	1,086	4,176	392	—	—
Preferred stock dividend	14	4	—	—	—
Net income attributable to common shareholders	$11,389	$19,292	$15,838	$20,853	$19,581
Earnings per share					
Basic:					
Continuing operations	$0.57	$0.83	$0.84	$1.16	$1.18
Discontinued operations	0.06	0.23	0.02	—	—
Basic earnings per share	$0.63	$1.06	$0.86	$1.16	$1.18
Diluted:					
Continuing operations	$0.57	$0.82	$0.83	$1.12	$1.12
Discontinued operations	0.06	0.18	0.02	—	—
Diluted earnings per share	$0.63	$1.00	$0.85	$1.12	$1.12
Dividends declared per share	$0.100	$0.100	$0.100	$0.100	$0.150
Weighted average number of common and common equivalent shares outstanding:					
Basic	18,126	17,826	18,108	17,791	16,515
Diluted	18,226	22,393	18,257	18,317	17,460
OPERATING AND FINANCIAL DATA:					
Funeral homes at end of period	167	161	164	167	170
Cemeteries at end of period	33	32	32	32	32
Funeral services performed	27,864	29,854	31,402	32,627	33,160
Preneed funeral contracts sold	6,792	8,125	6,940	7,797	7,639
Backlog of preneed funeral contracts	81,585	80,714	82,842	84,353	91,402

Backlog of preneed cemetery contracts	64,580	63,453	63,322	63,178	63,254
Average revenue per funeral contract	$5,347	$5,365	$5,453	$5,621	$5,642
Cremation rate	46.2 %	46.9 %	47.3 %	48.9 %	50.7 %
Depreciation and amortization	$9,916	$11,635	$11,923	$13,780	$15,421
BALANCE SHEET DATA:					
Total assets	$738,085	$746,599	$827,528	$833,139	$885,069
Long-term debt, net of current maturities	163,541	142,542	152,387	195,009	204,404
Convertible junior subordinated debenture	89,770	89,770	—	—	—
Convertible subordinated notes	—	—	114,542	115,227	119,596
Stockholders' equity	134,818	155,973	179,875	157,594	177,989

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ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

OVERVIEW

General

We operate in two business segments: funeral home operations, which 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 provide funeral and cemetery services and products on both an “at-need” (time of death) and “preneed” (planned prior to death) basis. At December 31, 2016, we operated 170 funeral homes in 28 states and 32 cemeteries in 11 states within the United States. For additional discussion about our overall business strategy, see Part I, Item 1, Business, Business Strategy.

Funeral and Cemetery Operations

Factors affecting our funeral operating results include: demographic trends relating to population growth and average age, which impact death rates and number of deaths; establishing and maintaining leading market share positions supported by strong local heritage and relationships; effectively responding to increasing cremation trends by selling complementary services and merchandise; controlling salary and merchandise costs; and exercising pricing leverage related to our at-need business to increase average revenue per contract. In simple terms, volume and price are the two variables that affect funeral revenues. The average revenue per contract is influenced by the mix of traditional and cremation services because our average cremation service revenue is approximately one-third of the average revenue earned from a traditional burial service. Funeral homes have a relatively fixed cost structure. Thus, small changes in revenues, up or down, normally cause significant changes to our profitability.

Our funeral contract volumes, including contracts from acquisitions, have increased from 27,864 in 2012 to 33,160 in 2016 (compound annual increase of 4.4%). Our funeral operating revenue, excluding financial revenue, has increased from $143.2 million in 2012 to $180.6 million in 2016 (compound annual increase of 6.0%). The increases are primarily a result of businesses we have acquired in the last five years and our ability to increase the average revenue per funeral through expanded service offerings and packages. Additional funeral revenue from preneed commissions and preneed funeral trust earnings has increased from $7.6 million in 2012 to $8.8 million in 2016. We experienced a 1.9% decrease in volumes in comparing the year ended December 31, 2016 to the year ended December 31, 2015 on a same store basis and the same store average revenue per contract for the year ended December 31, 2016 decreased 0.1% compared to the year ended December 31, 2015.

The percentage of funeral services involving cremations has increased from 46.2% for the year ended December 31, 2012 to 50.7% for the year ended December 31, 2016. On a same store basis, the cremation rate has risen from 46.3% in 2012 to 51.8% for the year ended December 31, 2016, while the cremation rate for our acquired funeral home businesses has risen from 43.5% for the year ended December 31, 2012 compared to 46.0% for the year ended December 31, 2016.

Cemetery operating results are affected by the size and success of our sales organization. Approximately 48.0% and 50.0% of our cemetery revenues related to preneed sales of interment rights and related merchandise and services for the years ended December 31, 2015 and 2016, respectively. We believe that changes in the economy and consumer confidence affect the amount of preneed cemetery operating revenues. Our cemetery financial performance from 2012 through 2016 was characterized by increasing levels of operating revenues and field-level cemetery profit margins. Cemetery operating revenue, excluding financial revenue, increased from $38.3 million in 2012 to $48.9 million in 2016 (compound annual increase of 6.3%) and increased 4.9% over 2015. Additional cemetery revenue from preneed finance charges and trust earnings has increased from $9.1 million in 2012 to $9.9 million in 2016 (compound annual increase of 2.0%). Changes in the capital markets and interest rates affect this component of our cemetery revenues. Our goal is to build broader and deeper teams of sales leaders and counselors in our larger and more strategically located cemeteries in order to focus on growth of our preneed property sales. Additionally, a portion of our capital expenditures is designed to continually expand our cemetery product offerings.

Financial Revenue

Income recognized from the investments in the preneed funeral trust funds, the cemetery merchandise and services trust funds and the perpetual care trust funds decreased $1.1 million, or 6.7% for the year ended December 31, 2016, as compared to 2015, as a result of fewer preneed contract maturities and lower average revenue per preneed contract. For the five year period ended December 31, 2016, the performance of the funds, which includes realized income and unrealized appreciation, resulted in a 66.3% return. Investment income realized in the perpetual care trust funds (except for capital gains) is recognized as income when earned in the portfolio. Investment income realized in the preneed funeral trust funds and the cemetery merchandise and services trust funds is allocated to the individual preneed contracts and deferred from revenue until the time that the services and merchandise are delivered to the customer.

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Acquisitions

During 2016, we acquired six funeral home businesses, two in Houston, Texas, one in Madera, California, one in Brookfield, Wisconsin, one in Burlington, North Carolina and one in Graham, North Carolina for the aggregate purchase price of approximately $32.8 million. The purchase price for the businesses consisted of approximately (i) $23.9 million paid in cash at closing and (ii) $8.9 million, the net present value of future deferred payments totaling $13.5 million. In 2015,we acquired two funeral home businesses, one in Clarksville, Tennessee and one in Wake Forest, North Carolina, for the aggregate purchase price of approximately $15.0 million.

OVERVIEW OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of the Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, we evaluate estimates and judgments, including those related to revenue recognition, realization of accounts receivable, inventories, goodwill, other intangible assets, property and equipment and deferred tax assets and liabilities. We base our estimates on historical experience, third party data and assumptions that we believe to be reasonable under the circumstances. The results of these considerations form the basis for making judgments about the amount and timing of 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 is based upon our Consolidated Financial Statements presented herewith, which have been prepared in accordance with United States generally accepted accounting principles ("GAAP"). Our significant accounting policies are more fully described in Part II, Item 8, Financial Statements and Supplementary Data, Note 1. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our Consolidated Financial Statements.

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. Sales taxes collected are recognized on a net basis in our Consolidated Financial Statements.

Allowances for bad debts and customer cancellations are provided at the date that the sale is recognized as revenue and are based on our historical experience and the current economic environment. We also monitor changes in delinquency rates 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 costs of originating preneed sales contracts. These costs are expensed as incurred.

Preneed Contracts

We sell interment rights, merchandise and services prior to the time of need, which is referred to as preneed. In many instances the customer pays for the preneed contract over a period of time. Cash proceeds from preneed sales less amounts that we may retain under state regulations are deposited to a trust or used to purchase a third-party insurance policy. The principal and accumulated earnings of the trusts are generally withdrawn at maturity (death) or cancellation. The cumulative trust income earned and the increases in insurance benefits on the insurance products are deferred until the service is performed. The customer receivables and amounts deposited in trusts that we control are primarily included in the non-current asset section of our Consolidated Balance Sheets. The preneed funeral contracts secured by third party insurance policies are not recorded as assets or liabilities of the Company.

In the opinion of management, the proceeds from the trust funds and the insurance policies at the time the preneed contracts mature will exceed the estimated future costs to perform services and provide products under such arrangements. The types of securities in which the trusts may invest are regulated by state agencies.

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Preneed Funeral and Cemetery Trust Funds

Our preneed and perpetual care trust funds are reported in accordance with the principles of consolidating Variable Interest Entities ("VIE's"). In the case of preneed trusts, the customers are the legal beneficiaries of the trusts. In the case of perpetual care trusts, we do not have a right to access the corpus in the perpetual care trusts. We have recognized financial interests of third parties in the trust funds in our financial statements as Deferred preneed funeral and cemetery receipts held in trust and Care trusts' corpus. The investments of such trust funds are classified as available-for-sale and are reported at fair market value; therefore, the unrealized gains and losses, as well as accumulated and undistributed income and realized gains and losses are recorded to Deferred preneed funeral and cemetery receipts held in trust and Care trusts' corpus on our Consolidated Balance Sheets. Our future obligations to deliver merchandise and services are reported at estimated settlement amounts. Preneed funeral and cemetery trust investments are reduced by the trust investment earnings that we have been allowed to withdraw in certain states prior to maturity. These earnings, along with preneed contract collections not required to be placed in trust, are recorded in Deferred preneed funeral revenue and Deferred preneed cemetery revenue until the service is performed or the merchandise is delivered.

In accordance with respective state laws, we are required to deposit a specified amount into perpetual and memorial care trust funds for each interment/entombment right and certain memorials sold. Income from the trust funds is distributed to us and used to provide for the care and maintenance of the cemeteries and mausoleums. Such trust fund income is recognized as revenue when realized by the trust and distributable to us. We are restricted from withdrawing any of the principal balances of these funds.

An enterprise is required to perform an analysis to determine whether the enterprise's variable interest(s) give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has both the power to direct the activities of the VIE that most significantly impact the entity's economic performance and the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. Our analysis continues to support our position as the primary beneficiary in the majority of our funeral and cemetery trust funds.

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 December 31, 2016, CSV RIA provided these services to two institutions, which have custody of 79% of our trust assets, for a fee based on the market value of trust assets. Under state trust laws, we are allowed to charge the trust a fee for advising on the investment of the trust assets and these fees are recognized as income in the period in which services are provided.

We determine whether or not the assets in the preneed trusts have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis of the investment due to an other-than-temporary impairment is likewise recorded as a reduction to Deferred preneed funeral and cemetery receipts held in trust and Care trusts' corpus on our Consolidated Balance Sheets. There will be no impact on earnings unless and until such time that the investment is withdrawn from the trust in accordance with state regulations at an amount that is less than its original basis.

See Part II, Item 8, Financial Statements and Supplementary Data, Notes 6 and 10 for additional related disclosures.

Long-Lived Assets

Long-lived assets, such as property, plant and equipment subject to depreciation and amortization, are reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with the Property, Plant and Equipment Topic of the Accounting Standards Codification ("ASC") 360. This guidance requires that long-lived assets to be held and used are reported at the lower of their carrying amount or fair value. We assess long-lived assets for impairment whenever events or circumstances indicate that the carrying value may be greater than the fair value. We evaluate our long-lived assets for impairment when a funeral home business has negative EBITDA for four consecutive years and if there has been a decline in EBITDA in that same period. For our cemetery business, we analyze the long-lived assets for impairment if the business has a negative operating margin and a decline in operating margin over a four year period. We review our long-lived assets deemed held-for-sale to the point of recoverability. Assets to be disposed of and assets not expected to provide any future service potential are recorded at the lower of their carrying amount or fair value less estimated cost to sell. If we determine that the carrying value is not recoverable from the proceeds of the sale, we record an impairment at that time. For the year ended December 31, 2016, no impairments were identified on our long-lived assets.

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

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Business Combinations

Tangible and intangible assets acquired and liabilities assumed are recorded at fair value and goodwill is recognized for any difference between the price of the acquisition and fair value. We recognize the assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at the acquisition date, measured at the fair value as of that date. Acquisition related costs are recognized separately from the acquisition and are expensed as incurred. We customarily estimate related transaction costs known at closing. To the extent that information not available to us at the closing date subsequently becomes available during the allocation period, we may adjust goodwill, intangible assets, assets or liabilities associated with the acquisition.

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

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.

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.

For the year ended December 31, 2014, we recognized an impairment of approximately $1.2 million for discontinued locations as the carrying value exceeded fair value. Upon receipt of a letter of intent to sell a location, we perform an analysis to determine if the net assets of the location exceed the sales price. If the net assets exceed the sales price, we record an impairment at the location level.

No impairments were recorded to our goodwill during the years ended December 31, 2015 and 2016. No such events or changes occurred between the testing date and year end to trigger a subsequent impairment review.

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

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

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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 31st to August 31st in 2016 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 third quarter of 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. No other impairments were recorded to our intangible assets during the years ended December 31, 2014, 2015 and 2016.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 12 for additional information.

Divested and Discontinued Operations

Effective January 1, 2015, we adopted the Financial Accounting Standards Board's ("FASB") guidance for reporting discontinued operations, which amended the definition of "discontinued operations" to include only disposals or held-for-sale classifications for components or groups of components of an entity that represent a strategic shift that either has or will have a major effect on an entity's operations or financial results. Examples of a strategic shift that has or will have a major effect on an entity's operations and financial results include a disposal of a major geographical area, line of business, equity method of investment or other parts of an entity. The new guidance also requires the disclosure of pre-tax income of disposals that do not qualify as discontinued operations.

During 2014, we sold a cemetery in Florida and two funeral homes, one in Ohio and one in Kentucky. For the year ended December 31, 2014, we recognized income from discontinued operations of $0.4 million. We did not divest any of our funeral home or cemetery businesses in 2015. During 2016, we sold a funeral home business in Tennessee for $1.35 million. The operating results of this business, as well as the loss on the sale are included within net income from continuing operations on our Consolidated Statements of Operations.

We continually review locations to optimize the sustainable earning power and return on our invested capital. These reviews could entail selling certain non-strategic businesses.

See Part II, Item 8, Financial Statements and Supplementary Data, Notes 5 for additional information.

Fair Value Measurements

We measure the available-for-sale securities held by our funeral merchandise and service, cemetery merchandise and service, and cemetery perpetual care trusts at fair value on a recurring basis in accordance with the Fair Value Measurements Topic of the ASC. This guidance defines fair value as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The guidance establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

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• Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets;
• Level 2 — inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and
• Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

We disclose the extent to which fair value is used to measure financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date. The fair value disclosures of transfers in and out of Levels 1 and 2 and the gross presentation of purchases, sales, issuances and settlements in the Level 3 reconciliation of the three-tier fair value hierarchy are also presented in Notes 6 and 10 to the Consolidated Financial Statements included herein. We currently do not have any assets that have fair values determined by Level 3 inputs and no liabilities measured at fair value. We have not elected to measure any additional financial instruments and certain other items at fair value that are not currently required to be measured at fair value.

To determine the fair value of assets and liabilities in an environment where the volume and level of activity for the asset or liability have significantly decreased, the exit price is used as the fair value measurement. For the year ended December 31, 2016, we did not incur significant decreases in the volume or level of activity of any asset or liability.

We consider an impairment of debt and equity securities other-than-temporary unless (a) we have the ability and intent to hold an investment and (b) evidence indicating the cost of the investment is recoverable before we are more likely than not required to sell the investment. If an impairment is indicated, then an adjustment is made to reduce the carrying amount to fair value which is recorded as a reduction to either Deferred preneed cemetery receipts held in trust, Deferred preneed funeral receipts held in trust or Care trusts' corpus on our Consolidated Balance Sheets. For the years ended December 31, 2015 and 2016, we recorded impairment charges of $1.8 million and $2.3 million, respectively, for other-than-temporary declines in fair value related to unrealized losses on certain investments.

In the ordinary course of business, we are typically exposed to a variety of market risks. Currently, these are primarily related to changes in fair market values related to outstanding debts and changes in the values of securities associated with the preneed and perpetual care trusts. Management is actively involved in monitoring exposure to market risk and developing and utilizing risk management techniques when appropriate and when available for a reasonable price. See Part II, Item 8, Financial Statements and Supplementary Data, Note 11 for additional information.

Presentation of Debt Issuance Costs

Effective January 1, 2016, we adopted the FASB's guidance on simplifying the presentation of debt issuance costs. The guidance 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 $3.6 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 2016, respectively. The amounts related to our Credit Facility were $1.4 million and $1.3 million as of December 31, 2015 and 2016, respectively. The amounts related to our Convertible Notes were $2.8 million and $2.3 million as of December 31, 2015 and 2016, respectively.

See Part II, Item 8, Financial Statements and Supplementary Data, Notes 13 and 14 for additional information.

Income Taxes

We and our subsidiaries file a consolidated United States Federal income tax return, separate income tax returns in 15 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. Effective January 1, 2016, we adopted the FASB's new guidance requiring that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position.

We record a valuation allowance to reflect the estimated amount of deferred tax assets for which realization is uncertain. Management reviews the valuation allowance at the end of each quarter and makes adjustments if it is determined that it is more likely than not that the tax benefits will be realized.

We analyze tax benefits for uncertain tax positions and how they are to be recognized, measured, and derecognized in the financial statements; provide certain disclosures of uncertain tax matters; and specify how reserves for uncertain tax positions should be classified on the Consolidated Balance Sheets.

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On August 1, 2014, we received notification that the Internal Revenue Service ("IRS") completed its examination of our tax year ended December 31, 2011. As a result, we recognized a tax benefit of $1.7 million which reduced our effective tax rate for the year ended December 31, 2014. Additionally, we recognized a credit to interest expense of $0.6 million related to the settled portion of the uncertain tax position.

On August 15, 2016, we settled an open examination with the California Franchise Tax Board. As a result of paying the final assessment, we re-measured our tax liability for unrecognized tax benefits reflecting a reduction to our liability of $0.2 million. On August 29, 2016, we received notification that the IRS completed its examination of our tax year ended December 31, 2013. As a result, we re-measured our tax liability for unrecognized tax benefits reflecting a reduction to our liability of $0.6 million, which resulted in an increase to Deferred tax liability in the amount of $0.6 million.

We do not have any unrecognized tax benefits recorded as of December 31, 2016 and we do not anticipate a material change in our unrecognized tax benefits during the next twelve months.

Effective January 1, 2016, we adopted the FASB's guidance on Balance Sheet Classification of Deferred Taxes. The standard simplifies deferred tax reporting on the balance sheet by eliminating non-current and current classifications. The guidance requires all deferred tax assets and liabilities, along with related valuation allowances will be classified as non-current on the balance sheet. The guidance was applied prospectively and all deferred tax assets and liabilities, along with our valuation allowance are now classified as non-current at December 31, 2016.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 16 for additional information.

Stock Plans and Stock-Based Compensation

We have stock-based employee and director compensation plans under which we may grant restricted stock, stock options, performance awards and our employee stock purchase plan under which stock may be purchased. We recognize compensation expense in an amount equal to the fair value of the share-based awards expected to vest over the requisite service period. Fair value is determined on the date of the grant. The fair value of options or awards containing options is determined using the Black-Scholes valuation model. The fair value of the performance awards is determined using a Monte-Carlo simulation pricing model.

See Part II, Item 8, Financial Statements and Supplementary Data, Note 17 for additional information.

Computation of Earnings per Common Share

Basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period. Dilutive common equivalent shares consist of stock options and our Convertible Notes.

Share-based awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are recognized as participating securities and included in the computation of both basic and diluted earnings per share. Our grants of restricted stock awards to our employees and directors are considered participating securities, and we have prepared our earnings per share calculations attributable to common stockholders to exclude outstanding unvested restricted stock awards, using the two-class method, in both the basic and diluted weighted average shares outstanding calculation.

The fully diluted weighted average shares outstanding for the years ended December 31, 2015 and 2016, and the corresponding calculation of fully diluted earnings per share, included approximately 0.3 million and 0.5 million 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. There were no shares that would have been issued upon conversion under the if-converted method for our convertible subordinated notes for the year ended December 31, 2014.

The calculations for basic and diluted earnings per share for the three years ended December 31, 2014, 2015 and 2016 are presented in Part II, Item 8, Financial Statements and Supplementary Data, Note 19.

Subsequent Events

We have evaluated events and transactions during the period subsequent to December 31, 2016 through the date the financial statements were issued for potential recognition or disclosure in the accompanying financial statements covered by this report.

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RECENT ACCOUNTING PRONOUNCEMENTS, ACCOUNTING CHANGES AND OTHER REGULATIONS

Goodwill

In January 2017, the FASB issued ASU, Intangibles – Goodwill and Other (Topic 350). This ASU applies to all entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. The amendment simplifies subsequent measurement of goodwill and eliminates Step 2 from the goodwill impairment test, which should reduce the cost and complexity of evaluating goodwill for impairment. An entity no longer will determine goodwill impairment by calculating the implied fair value of goodwill by assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination. Instead, impairment is defined as the amount by which the carrying value of the reporting unit exceeds its fair value, up to the total amount of goodwill. This ASU is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. Our adoption of this ASU for our fiscal year beginning January 1, 2017 is not expected to have a material effect on our Consolidated Financial Statements.

Stock-Based Compensation

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. Our adoption of this ASU for our fiscal year beginning January 1, 2017 is not expected to have a material effect on our Consolidated Financial Statements.

Inventory

In July 2015, the FASB issued ASU, Inventory – Simplifying the Measurement of Inventory (Topic 330). This ASU applies to all inventory, including inventory that is measured using the first-in, first-out (FIFO) or average cost method. This ASU does not apply to the last-in, first-out (LIFO) or the retail inventory method. This ASU requires an entity to measure inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, and should be applied prospectively, with earlier application permitted as of the beginning of an interim or annual reporting period. Our adoption of this ASU for our fiscal year beginning January 1, 2017 is not expected to have a material effect on our Consolidated Financial Statements.

Revenue Recognition

In May 2014, the FASB issued ASU, Revenue from Contracts with Customers. (Topic 606). ASC Topic 606 supersedes the revenue recognition requirements under ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the ASC. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. Under the new guidance, an entity is required to perform the following five steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The new guidance will significantly enhance comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. Additionally, the guidance requires improved disclosures as to the nature, amount, timing and uncertainty of revenue that is recognized. On July 9, 2015, the FASB deferred the effective date by one year to annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2018.

We expect the adoption of this new accounting standard to affect our accounting for cemetery interment rights. Currently, our 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.

Under the new accounting standard, we will recognize the revenue in the period in which the sale occurs, irrespective of the cumulative payments received. The impact of this is not expected to have a material impact on our Consolidated Financial Statements. Upon revenue recognition, management will book an allowance for contract cancellations based on our previous

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experience of cancellations and as such will reflect a one-time catch up for the allowance at January 1, 2018, which is not expected to have a material impact on our Consolidated Financial Statements.

Costs related to the sales of interment rights, which include real property and other costs related to cemetery development activities, will continue to be charged to operations using the specific identification method in the period in which the sale of the interment right is recognized as revenue. We do not expect the adoption of this accounting standard to materially affect our accounting for other revenue streams.

We are currently modifying our financial systems to provide accounting under the new method in addition to our current method and do not anticipate any business disruption related to adopting this guidance. We are continually evaluating the impact on our Consolidated Financial Statements with more recent financial information.

Cash Flows

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 eight specific cash flow issues and includes clarification on how these items should be classified in the statement of cash flows and is designed to help eliminate diversity in practice as to where items are classified in the cash flow statement.

In November 2016, the FASB issued additional guidance on this Topic that requires amounts generally described as restricted cash and restricted cash equivalents to be included with cash and cash equivalents when reconciling the statement of cash flows. 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. 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.

Business Combinations

In January 2017, the FASB issued Accounting Standards Update (“ASU”), Business Combinations – Clarifying the Definition of a Business (Topic 805). This ASU applies to all entities that must determine whether they have acquired or sold a business. The amendments in this Update clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This ASU is effective for fiscal years beginning after December 15, 2017, including the interim periods within those periods, with earlier application permitted. Our adoption of this ASU for our fiscal year beginning January 1, 2018 is not expected to have a material effect 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.

Financial Instruments

In January 2016, the FASB issued ASU, Financial Instruments – Overall - Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825). The amendments in this ASU address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments and apply to all entities that hold financial assets or owe financial liabilities. The amendments in this ASU also simplify the impairment assessment of equity investments without readily determinable fair values by requiring assessment for impairment qualitatively at each reporting period. That impairment assessment is similar to the qualitative assessment for long-lived assets, goodwill, and indefinite-lived intangible assets. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with earlier application permitted for financial statements that have not been issued. 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.

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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 main objective of the ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. This amendment replaces the incurred loss impairment methodology in the current standard with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, with earlier application permitted for all entities. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2020 and are currently evaluating the impact the adoption of this new accounting standard will have on our Consolidated Financial Statements.

SELECTED INCOME AND OPERATIONAL DATA

The following table sets forth certain income statement data for us expressed as a percentage of net revenues for the periods presented:

	Year Ended December 31,		
	2014	2015	2016
Total gross profit	31.0 %	32.0 %	32.1 %
General and administrative expenses	13.4 %	11.9 %	11.9 %
Operating income	17.6 %	20.1 %	20.2 %
Interest expense	4.6 %	4.4 %	4.7 %

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

	Year Ended December 31,		
	2014	2015	2016
Funeral homes at beginning of period	161	164	167
Acquisitions	6	2	6
Constructed funeral homes	—	3	—
Divestitures	(2)	—	(1)
Mergers and relocation of funeral homes	(1)	(2)	(2)
Funeral homes at end of period	164	167	170
Cemeteries at beginning of period	32	32	32
Acquisitions	1	—	—
Divestitures	(1)	—	—
Cemeteries at end of period	32	32	32

REPORTING AND NON-GAAP FINANCIAL MEASURES

We also present our financial performance in our “Operating and Financial Trend Report” (“Trend Report”) as reported in our earnings release for the year ending December 31, 2016 dated February 15, 2017 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.

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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). In addition, our presentation of these measures may not be comparable to similarly titled measures in other companies' reports.

The non-GAAP definitions we use 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 year ended December 31, 2015 and 35 percent for the year ended December 31, 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 prior to 2016 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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Below is a reconciliation of Net Income (a GAAP measure) to Adjusted Net Income (a non-GAAP measure) for the years ended December 31, 2015 and 2016.

	Year Ended December 31,	
	2015	2016
	(in millions)	
Net Income	$ 20.8	$ 19.6
Special Items, net of tax except for items noted by**		
Withdrawable Trust Income	0.4	n/a
Acquisition and Divestiture Expenses	0.4	0.4
Severance and Retirement Costs	0.6	2.6
Consulting Fees	1.3	0.3
Accretion of Discount on Convertible Subordinated Notes**	3.5	3.9
Loss on Extinguishment of Debt	—	0.4
Net Gain/Loss on Sale of Assets	—	1.1
Other Special Items	0.2	—
Tax Adjustment from Prior Period**	0.1	—
Adjusted Net Income	$ 27.3	$ 28.3

YEAR ENDED DECEMBER 31, 2016 COMPARED TO YEAR ENDED DECEMBER 31, 2015

Financial Highlights

Total revenue for the year ended December 31, 2016 and 2015 was $248.2 million and $242.5 million, respectively, which represents an increase of approximately $5.7 million, or 2.3%. For the year comparatives, we experienced a 1.6% increase in total funeral contracts and a slight increase in the average revenue per funeral contract of 0.4%. In addition, while we experienced a decrease of 6.3% in the number of preneed interment rights (property) sold, the average price per interment right sold increased 5.7%. 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 $1.6 million, or 3.2%, due primarily to better cost management in our same store funeral home operations, increases in funeral acquisition revenues as well as increases in preneed property 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 year ended December 31, 2016 decreased $1.3 million to $19.6 million, equal to $1.12 per diluted share, compared to net income of $20.8 million, equal to $1.12 per diluted share, for the year ended December 31, 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.”

The following is a discussion of our results of operations for the years ended December 31, 2016 and 2015. The term “same store” or “existing operations” refers to funeral homes and cemeteries acquired prior to January 1, 2012 and owned 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 and regional and unallocated funeral and cemetery costs are not included in operating profit.

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Results of Operations

Funeral Home Segment. The following table sets forth certain information regarding our revenues and operating profit from funeral home continuing operations for the year ended December 31, 2015 compared to the year ended December 31, 2016.

	Year Ended December 31,		Change	
	2015	2016	Amount	Percent
	(dollars in thousands)			
Revenues:				
Same store operating revenue	$142,690	$140,459	$(2,231)	(1.6)%
Acquired operating revenue	33,678	40,165	6,487	19.3 %
Preneed funeral insurance commissions	1,484	1,429	(55)	(3.7)%
Preneed funeral trust earnings	7,966	7,348	(618)	(7.8)%
Revenues from continuing operations	$185,818	$189,401	$3,583	1.9 %
Operating profit:				
Same store operating profit	$54,620	$54,706	$86	0.2 %
Acquired operating profit	13,693	16,536	2,843	20.8 %
Preneed funeral insurance commissions	454	682	228	50.2 %
Preneed funeral trust earnings	7,885	7,259	(626)	(7.9)%
Gross profit from continuing operations	$76,652	$79,183	$2,531	3.3 %

Funeral home same store operating revenues for the year ended December 31, 2016 decreased $2.2 million, or 1.6%, when compared to the year ended December 31, 2015. This decrease was primarily due to a 1.9% decrease in same store contract volume to 26,636, while the average revenue per contract remained flat at $5,273. The average revenue per contract excludes the impact of preneed funeral trust earnings (separately reflected in Revenue 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 remained flat at $5,471 for the year ended December 31, 2016. The average revenue per burial contract increased 1.8% to $8,819, while the number of traditional burial contracts decreased 5.6% to 10,875. The number of cremation contracts increased 1.3% to 13,801, and the average revenue per cremation contract increased 1.0% to $3,274. The burial rate decreased 170 basis points to 40.8% and the cremation rate increased 160 basis points to 51.8% for the year ended December 31, 2016 when compared to the year ended December 31, 2015. The average revenue for “other” contracts, which are charges for merchandise and services for which we do not perform a funeral service and which make up approximately 7.4% of the total number of contracts for the year ended December 31, 2016, increased 3.1% to $2,371.

Same store operating profit for the year ended December 31, 2016 increased $0.1 million, or 0.2%, from the year ended December 31, 2015, despite the decrease in operating revenues. This is primarily the result of better management of expenses, which decreased $1.5 million or 2.1% when compared to the same period in 2015. Those expenses with significant decreases include facilities and grounds expenses, which decreased by $0.9 million, general liability and other insurance expenses, which decreased by $0.4 million, and salaries and benefits expense, which decreased by $0.2 million.

Funeral home acquired revenues for the year ended December 31, 2016 increased $6.5 million, or 19.3%, when compared to the year ended December 31, 2015, as we experienced a 19.1% increase in the acquired contract volume to 6,524, while the average revenue per contract increased 0.2% to $6,157. The average revenue per contract excludes the impact of preneed funeral trust earnings (separately reflected in Revenue above) recognized at the time that we provide the services pursuant to the preneed contract. Including funeral trust earnings, the average revenue per contract remained flat at $6,342 for the year ended December 31, 2016. The average revenue per burial contract increased 3.4% to $9,258, and the number of traditional burial contracts increased 10.5% to $3,012. The number of cremation contracts increased 28.3% to 3,003, and the average revenue per cremation contract increased 4.0% to $4,110. The 2016 funeral home acquired portfolio includes six businesses acquired during 2016 not present in 2015.

These businesses increased revenue by $3.0 million and contract volume by 500 contracts in the year ended December 31, 2016.

Acquired operating profit for the year ended December 31, 2016 increased $2.8 million, or 20.8%, from the year ended December 31, 2015. This increase is a result of an increase in revenues, offset by a $2.9 million or 18.4% increase in expenses. The operating profit for the year ended December 31, 2016 includes $1.1 million related to the 2016 funeral home acquired portfolio. The most significant change was in salaries and benefits (the largest controllable expense), which increased $1.8 million, general and administrative expenses increased $0.7 million, facilities and grounds expenses increased $0.2 million and general