

CARRIAGE SERVICES INC
Form 10-K
March 06, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF
1934

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For the fiscal year ended, December 31, 2013
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
(State or other jurisdiction of
incorporation or organization)
3040 Post Oak Blvd., Suite 300, Houston, Texas
(Address of principal executive offices)
76-0423828
(I.R.S. Employer
Identification No.)
77056
(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
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
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

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 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. (Check one):

Large accelerated filer Accelerated filer

Non-Accelerated filer (Do not check if a smaller reporting company) Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Securities Exchange Act of 1934. Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2013 was approximately \$278.2 million based on the closing price of \$17.45 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 28, 2014 was 18,243,722.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its 2014 annual meeting of stockholders, which will be filed with the Securities and Exchange Commission within 120 days of December 31, 2013, 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 “believe,” “expect,” “anticipate,” “plan,” “intend,” “foresee,” “should,” “would,” “could” or other similar expressions are intended to identify forward-looking statements, which are generally not historical in nature. These forward-looking statements 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. Known material factors that could cause our actual results to differ from those in the forward-looking statements are those described in 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.

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 of 1993 and is a leading provider of deathcare services and merchandise in the United States. We operate in two business segments: funeral home operations, which currently account for approximately 75% of our total revenue, and cemetery operations, which currently account for approximately 25% of our total revenue. At December 31, 2013, we operated 161 funeral homes in 26 states and 32 cemeteries in 10 states. We mainly serve suburban and rural markets, where we primarily compete with smaller, independent operators and believe we are a market leader (first or second) in most of our markets. We provide funeral and cemetery services and products on both an “at-need” (time of death) and “preneed” (planned prior to death) basis.

Our operations are reported in two business segments:

Funeral Home Operations. Funeral homes are principally service businesses that provide funeral services (traditional burial and cremation) and sell related merchandise, such as caskets and urns. Given the high fixed cost structure associated with funeral home operations, we believe the following key factors affect our profitability:

- demographic trends in terms of population growth and average age, which impact death rates and number of deaths;
- our ability to establish and maintain market share positions supported by strong local heritage and relationships;
- our ability to effectively respond to increasing cremation trends by packaging complimentary services and merchandise;
- our ability to control salary, merchandise and other controllable costs; and
- our ability to exercise pricing leverage related to our at-need business to increase average revenues per contract.

Cemetery Operations. Cemeteries are primarily a sales business providing interment rights (grave sites and mausoleums) and related merchandise, such as markers and memorials. Our cemetery operating results are impacted by the size and success of our sales organization, as approximately 48% of our cemetery revenues during the year ended December 31, 2013 were generated from preneed sales of interment rights and related merchandise and services. We believe that changes in the economy and consumer confidence may impact the amount of preneed cemetery revenues. Cemetery revenues generated from at-need service and merchandise sales generally are subject to many of the same key profitability factors as our funeral home business. Approximately 19% of our cemetery revenues during the year ended December 31, 2013 were attributable to investment earnings on trust funds and finance charges on installment contracts. Changes in the capital markets and interest rates affect this component of our cemetery revenues, along with changes that we make in the investment securities within the trust funds.

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RECENT DEVELOPMENTS

Credit Facility. On April 24, 2013, we entered into a third amendment (the “Third Amendment”) to our secured bank credit facility (the “Credit Facility”), which increased the revolving credit commitments under our revolving credit facility from \$105 million to \$125 million and decreased the interest rate margin. The Third Amendment decreased the applicable margin for our outstanding borrowings (for both prime rate and LIBOR base rates) by 50 basis points at each leverage ratio threshold. In connection with the Third Amendment, we recorded a pre-tax charge of approximately \$0.4 million in the second quarter to write-off unamortized loan costs. The Third Amendment also contains amendments which (a) allow us to issue subordinated debt or convertible subordinated debt in an amount not to exceed \$100 million, (b) provides us the ability to repurchase up to \$15 million of stock-based employee awards, and (c) allows us to refinance our existing convertible junior subordinated debentures with the proceeds of certain issuances of subordinated debt or convertible subordinated debt. Our Credit Facility matures on September 30, 2017 and is collateralized by all personal property and funeral home real property in certain states. We have the option to pay interest under our Credit Facility at either the prime rate or LIBOR rate plus a margin based on the our leverage ratio. As of December 31, 2013, the prime rate margin was equivalent to 1.50% and the LIBOR margin was 2.50%. The weighted average interest rate on our Credit Facility for the year ended December 31, 2013 was 3.20%.

Acquisitions. We completed one acquisition during 2013 consisting of two funeral homes, one in Tennessee and one in Georgia, and are positioned to acquire more funeral home and cemetery businesses in the future. The aggregate consideration paid for these businesses was approximately \$13.7 million. We acquired substantially all the assets and assumed certain operating liabilities, including obligations associated with existing preneed contracts.

Discontinued Operations. We sold seven funeral homes and one cemetery in 2013. The aggregate consideration received for these divestitures was approximately \$10.2 million. At December 31, 2013, we had one letter of intent for the sale of a cemetery in Florida, which we subsequently sold in January 2014.

Capital. Our Board of Directors (“our Board”) approved four quarterly dividends of \$0.025 per share. For fiscal year 2013, we paid approximately \$1.8 million in dividends.

Performance-Based Stock Awards. On January 3, 2014, we cancelled all the outstanding Performance-Based Stock Awards. All holders of these performance-based stock awards surrendered their shares in exchange for a cash payout of approximately \$16.1 million.

DEATHCARE INDUSTRY

Deathcare companies 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 deathcare industry in the United States is characterized by the following fundamental attributes (the statistics included in this Form 10-K are from reports compiled by Sundale Research which are based on information from the United States (“U.S.”) Department of Commerce).

Deaths and Death Rates

Death rates and the number of deaths in the United States have been relatively stable on a long-term historical basis. The number of deaths in the United States increased at an annual rate of approximately 1% for the period from 1980 to 2000. Beginning in 2001, the number of deaths has trended slightly lower as the general population is living longer and because of low birth rates in the period from the early 1930’s to the mid 1940’s during the Great Depression and World War II. In 2012, the number of deaths fell by 0.6% compared to 2011. The number of deaths is estimated to drop again in 2013. The recent trend is projected to reverse in coming years due to the aging of the “baby boomer” generation. The number of people age 65 and over is expected to increase from 42.6 million in 2012 to 49.6 million in 2017, reflecting an average annual growth rate of 3.1%.

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Cremation

In recent years, there has been a steady, gradual increase in the number of families in the United States that have chosen cremation as an alternative to traditional methods of burial. Cremations represented approximately 43.2% of the U.S. burial market in 2012 and are predicted to increase to 50% by 2017. In 2012, the number of cremations increased by 2.2%, following increases of 6.4% and 7.5% in the previous two years, respectively. Cremation rates can vary significantly based upon geographic, religious and cultural traditions. Direct cremation has been offered as a less costly alternative to a traditional funeral service. However, cremation is being increasingly accepted as part of a package of funeral services that includes memorials, merchandise and options for the interment of cremated remains. Cremations result in lower absolute revenue dollars, but higher gross margins. Cemeteries are more affected by the increasing cremation trend than funeral homes.

Highly Fragmented Ownership

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. In December 2013, SCI completed its acquisition of Stewart Enterprises, Inc., which, prior to the merger, was one of the largest public operators, in terms of revenue, of both funeral homes and cemeteries. We believe these three companies collectively represent approximately 20% of deathcare 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. The top 50 deathcare companies account for only 25% of industry revenue. All of our acquisitions in both 2012 and 2013 were independent businesses.

Heritage and Tradition

Deathcare 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.

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. The business strategy is executed through our “Standards Operating Model,” a decentralized and entrepreneurial operating model for our funeral home and cemetery businesses. To date, our Standards Operating Model has driven significant changes in our organization, leadership and operating practices. We use the Standards Operating Model to measure the sustainable revenue growth and earning power of our portfolio of deathcare businesses. Our Standards Operating Model emphasizes growing market share and improving long-term profitability by employing leadership and entrepreneurial principles that fit the nature of our local, personal service, high value business. Leadership qualities are evaluated using the 4E leadership characteristics – Energy, Energize Others, Edge and Execution. This model requires our local and corporate leaders to focus on the drivers of success that create long-term profitability and value for our stockholders. Our Standards Operating Model emphasizes:

- decentralized management of our local businesses;
- financial and operational standards based upon key drivers of success of our best businesses;
- variable compensation that rewards our managers as if they were owners;
- finding, developing and retaining the best people in our industry; and
- information technology designed to support local businesses and corporate management decisions, measure performance of our businesses against our financial and operational standards, and ensure adherence to established internal control procedures.

Our business objectives include:

- growing market share, creating new heritage, producing consistent, modest revenue growth and sustaining increased earnings and cash flow;
- continuing to improve our operating and financial performance by executing our Standards Operating Model;
-

upgrading the leadership in our businesses, as necessary; and searching for well-qualified personnel that we feel will lead and excel within our Standards Operating Model; and
• executing our Strategic Acquisition Model, a disciplined program that will guide our acquisition strategies, to accelerate growth while maintaining financial discipline.

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Key elements of our overall business strategy include the following:

Implement Operating Initiatives. Our Standards Operating Model is based on operating standards designed to grow market share and increase profitability, developed from our best operations, along with an incentive compensation plan to reward business managers known as “Managing Partners” and their staff for successfully meeting or exceeding such standards. Our Managing Partners participate in a variable bonus plan in which they earn a percentage of their business’ earnings based upon the actual standards achieved. Our Standards Operating model and the underlying standards, which we refer to as “Being the Best,” focus on what we believe are the key drivers of a successful operation, organized around three primary areas - market share, people and operating financial metrics. Our Standards Operating Model is the measure by which we judge the success of each business. 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 4 to 6 times their average annual bonus, if such Managing Partners are able to achieve an annual compound growth rate of 2% over a five year period. To date, our Standards Operating Model has driven significant changes in our organization, leadership and operating practices. Most importantly, our Standards Operating Model has allowed us to measure the sustainable revenue growth and earning power of our portfolio businesses. Our Standards Operating Model led to the development of our “Strategic Acquisition Model” during 2006, which guides our acquisition and disposition strategies. Both models, when executed effectively, should drive long term, sustainable increases in market share, revenue, earnings and free cash flow. The standards are not designed to produce maximum short-term earnings because we do not believe such performance is sustainable without ultimately stressing the business, which often leads to declining market share, revenues and earnings.

Enhancement of Funeral Services. A significant trend in the deathcare industry is an increasing preference of our client families for cremation. The percentage of funeral services performed by our funeral homes for which cremation was chosen as the manner in which to dispose of remains was 45.1% for the year ended December 31, 2011, 46.1% for the year ended December 31, 2012 and 46.8% for the year ended December 31, 2013. For the year ended December 31, 2013, 67.1% of our total cremation services were direct cremations (where no memorial service or visitation is involved, although merchandise may be sold) and 32.9% included services, as compared to 64.8% and 35.2%, respectively, for the year ended December 31, 2012. 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 services. 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 services and merchandise.

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. 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 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. A significant portion of our historical cemetery revenues are represented by sales of cemetery property sold by our sales professionals on a preneed basis and finance charges earned on preneed installment contracts. General consumer confidence and discretionary income have a significant impact on our preneed sales success rate. In 2013, preneed cemetery sales increased 10.8% compared to 2012.

Corporate Development Efforts. We believe that our capital structure positions us to pursue a strategy of disciplined growth, affording us the flexibility to redeploy our cash and cash flow toward selective acquisitions that meet our criteria. We expect to continue to improve our earning power as we invest in businesses that will contribute incremental revenues, earnings and cash flow. Our Strategic Acquisition Model is a primary driver of our acquisition strategy. We use strategic ranking criteria to assess acquisition candidates in order to optimize the sustainable earning

power of our deathcare portfolio.

Ideal acquisition candidates include businesses that are demonstrated market leaders, are larger businesses located in growing markets with high barriers to entry and have field-level operating margins consistent with our best performing businesses. We believe there are large enough markets for us to increase our presence in existing markets by acquisition or to enter a new market with a substantial acquisition while leveraging our strong local franchise brands and entrepreneurial leadership. We also use our Standards Operating Model to evaluate acquisition candidates to ensure they can be readily integrated into our portfolio.

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OUR STRENGTHS

Market Leader in our Suburban and Rural Markets. Our operations are located in principally suburban and rural markets, where we primarily compete with smaller, independent operators. We focus on markets that perform better than the industry average and are generally insulated from economic and demographic changes.

Partnership Culture. Our funeral homes and cemeteries are managed by Managing Partners, individuals with extensive deathcare 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 that are custom designed for each of four groupings using size of business and cremation rate as specific grouping criteria. 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 management maintains supervisory controls and provides support services from our corporate headquarters. 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. Currently, we have four primary components in our capital structure:

- a \$130 million term loan with a 2017 maturity, of which \$117.0 million was outstanding at December 31, 2013;
- a \$125 million revolving credit facility with a 2017 maturity, of which \$36.9 million was outstanding at December 31, 2013;
- the \$89.8 million convertible junior subordinated 7% debenture with a 2029 maturity; and
- our common stock.

For additional information, please see Part II, Item 7, Liquidity and Capital Resources.

Stable Cash Flow. We have demonstrated the ability to generate strong and stable cash flow. Cash flow from continuing operations for 2013 totaled \$39.8 million, which was used primarily to acquire two funeral homes and for payments on our revolving credit facility, as well as other working capital needs. Going forward, 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 our field-level gross profit margins are among the highest reported by the public companies in the deathcare industry and that this performance is a testament to the success of our business strategies. As a percentage of revenues, the total field-level gross profit margin was 30.1% for the year ended December 31, 2013. These 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 Management 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 approximately 80% 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 Management Team. Our management team, headed by our founder, Chairman and Chief Executive Officer, Melvin C. Payne, and our Vice Chairman of our Board and Executive Vice President, L. William Heiligbrodt, is characterized by a dynamic culture that focuses on addressing changing market conditions and emerging trends in the funeral services

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industry. We believe our culture emphasizing the 4E's (Energy, Energize Others, Edge and Execution) leadership characteristics is critical and will provide an important advantage as the deathcare industry evolves. We are committed to continue operating an efficient corporate organization and strengthening our corporate and local business leadership. We believe that our Standards Operating Model will ensure this commitment at all levels of the organization. Our businesses are organized into three regions, each headed by a Regional Partner. 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, 2013, we operated 161 funeral homes in 26 states. Funeral home revenues currently account for approximately 75% of our total revenues. The funeral home operations are managed by a team of experienced deathcare industry professionals and selected region-level individuals with substantial management experience in our industry. See Part II, Item 8, Financial Statements and Supplementary Data, Note 21 for segment data related to 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 twenty-four hours. Given the high fixed cost structure associated with funeral home operations, we believe the following are key factors affecting our profitability:

- demographic trends in terms of 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 packaging complementary services and merchandise;
- controlling salary, merchandise and other controllable costs; and
- increasing average revenues per contract.

Cemetery Operations

As of December 31, 2013, we operated 32 cemeteries in 10 states. The cemetery operations are managed by a team of experienced deathcare industry and sales professionals. Cemetery revenues currently account for approximately 25% of our total revenues. See Part II, Item 8, Financial Statements and Supplementary Data, Note 21 for segment data related to 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.

Our cemetery operating results are impacted by the size and success of our sales organization, evidenced by the statistic that approximately 40% of our cemetery revenues for the year ended December 31, 2013 were generated from preneed sales of interment rights. An additional 9% of our 2013 cemetery revenues were generated from deliveries of merchandise and services previously sold on preneed contracts. We believe that changes in the economy and consumer confidence impacts the success rate of preneed sales and is currently having an impact on our preneed sales success rate and the industry as a whole. Coming into a more stable economy, we have focused more on quality sales counselors rather than quantity. Cemetery revenues

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generated from at-need services and merchandise sales generally are subject to many of the same key profitability factors as in our funeral home business. Approximately 19% of our cemetery revenue was attributable to investment earnings on trust funds and finance charges on installment contracts during the year ended December 31, 2013. Changes in the capital markets and interest rates affect this component of our cemetery revenues.

Preneed Programs

As discussed in the preceding sections, we market funeral and cemetery services and products on a preneed basis. 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 purchase of a life insurance policy, the proceeds of which will pay for such services at the time of need. Insurance policies, 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 as Preneed Insurance Commission within Funeral Revenues. 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 client 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 as Preneed Cemetery Finance Charges within Cemetery Revenues. 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. 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 6,844 and 8,183 preneed funeral contracts during the years ended December 31, 2012 and 2013, respectively. At December 31, 2013, we had a backlog of 80,714 preneed funeral contracts to be delivered in the future. Approximately 20% of the funeral revenues recognized during the years ended December 31, 2012 and 2013 originated through preneed contracts. Cemetery revenues that originated from preneed contracts represented approximately 47% and 48% of our net cemetery revenues for 2012 and 2013, respectively.

At December 31, 2013, we employed a staff of 138 advance-planning and family service representatives for the sale of preneed products and services.

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 investment registered advisory firm, CSV RIA, or by independent financial advisors. At December 31, 2013, CSV RIA provided these services to three institutions, which have custody of 78% of our trust assets, for a fee based on the market value of trust assets.

Preneed funeral sales generally require deposits to a trust or purchase of a third-party insurance product. Trust fund income earned and the receipt and recognition of any insurance benefits are deferred until the service is performed. 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

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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 \$398.2 million as of December 31, 2013.

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 purchased and 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 were able to withdraw \$1.4 million in trust income prior to delivery in those states in 2012 and \$1.7 million in 2013. Cemetery merchandise and service trust fund balances totaled approximately \$68.3 million as of December 31, 2013.

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, in Cemetery Revenues. 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 \$42.3 million at December 31, 2013.

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 deathcare industry has been highly competitive. Publicly traded companies operating in the United States include SCI, StoneMor and Carriage. In December 2013, SCI completed its acquisition of Stewart Enterprises, Inc. 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 in any one market may have impacted our profitability because of the high fixed cost nature of funeral homes. 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 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 price information and various other disclosures about funeral goods and services

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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; and (iv) requiring consumers to buy certain funeral goods or services as condition for furnishing other funeral goods or services.

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. Failure to comply with environmental laws and regulations could result in the assessment of substantial administrative, civil, and criminal penalties, the imposition of investigatory and remedial obligations, and the issuance of injunctions restricting or prohibiting some or all of our activities. 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.

EMPLOYEES

As of December 31, 2013, we and our subsidiaries employed 2,072 employees, of whom 935 were full-time and 1,137 were part-time. All of our funeral directors and embalmers possess licenses required by applicable regulatory agencies. We believe that we maintain a good relationship with our employees. 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, DC 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 an internet site <http://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 “Investor Relations-Investor Relations Menu – 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, Corporate Governance Committee, Executive Committee and Investment Committee. Copies of the Code of Business Conduct and Ethics and the Corporate Governance Guidelines are also posted on our website under the “Corporate

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Governance” section. 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

Improved performance in our funeral and cemetery segments is highly 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.

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.

Deathcare 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 qualified 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 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.

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

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.

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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 emphasize the sale of such contracts. If our efforts to increase such sales are successful, however, our current cash flows could be adversely affected.

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 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 2011, 2012 and 2013:

	2011	2012	2013	
Preneed funeral trust funds	(2.0	)% 14.3	% 13.2	%
Preneed cemetery trust funds	(2.7	)% 19.3	% 14.2	%
Perpetual care trust funds	(3.3	)% 20.1	% 14.2	%

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 declines in 2014 or 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, 2013, no such charge was required. Our preneed trusts are currently over funded based on performance for the past five years. 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.

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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, 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 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.

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.

There is no assurance that we will be able to continue to identify 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.

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, which result from recent federal legislation or state and local governments raising taxes in an effort to balance budgets. These costs are difficult to quantify in the future and may impair our ability to achieve earnings growth in excess of revenue growth. Our forecast assumes that we will be successful in increasing earnings at a rate that is greater than revenue growth. We can give no assurance that we will be successful in achieving such increases.

Covenant restrictions under our debt instruments may limit our flexibility in operating and growing our business. The terms of our Credit Facility and the convertible junior subordinated debenture 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 Facility 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

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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 Facility, the lenders thereunder may be entitled to sell certain of our funeral assets to satisfy our obligations under the agreement.

Continued economic, financial and stock market fluctuations could affect future potential earnings and cash flows and could result in future goodwill or long-lived asset impairments.

In addition to an annual review, we assess the impairment of goodwill 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 impairment test we performed as of August 31, 2013 and our annual review of long-lived assets as of December 31, 2013, we concluded that there was no impairment of our goodwill 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 an impairment of our goodwill.

Health care reform could increase health care costs and may have a negative impact on earnings and cash flows.

In March 2010, comprehensive health care reform legislation under the Patient Protection and Affordable Care Act and the Health Care Education and Affordability Reconciliation Act was passed and signed into law. Provisions of the health reform legislation become effective at various dates over the next several years, and many of the regulations and guidance with respect to the health care reform legislation have not been implemented. Due to the breadth and complexity of the health reform legislation, the lack of implementing regulations and interpretive guidance, and the phased-in nature of the implementation, it is difficult to predict the overall impact of the health reform legislation on our business over the coming years. To the extent that we are unable to pass these cost increases on to our customers, they could have a negative impact on our earnings 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 will end 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 cash, shares of our common stock or 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. In the event that a large number of our Managing Partners earn a bonus under this program, we could incur a material outlay of capital in 2017 and this incentive program could result in a decrease in net income.

RISKS RELATED TO THE DEATHCARE 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 U.S. 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.

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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 deathcare 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.

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. For example, federal, state, local and other regulatory agencies have considered and may enact additional legislation or regulations that could affect the deathcare industry. 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 deathcare 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 administrative, civil and criminal penalties, imposition of investigatory or remedial obligations and

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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, 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.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

At December 31, 2013, we operated 161 funeral homes in 26 states and 32 cemeteries in 10 states. We own the real estate and buildings for 130 of our funeral homes and lease 31 facilities. We own 28 cemeteries and operate four cemeteries under long-term contracts with municipalities and non-profit organizations at December 31, 2013. Eleven funeral homes are operated in combination with cemeteries as these locations are physically located on the same property or very close proximity and under the same management. The 32 cemeteries operated by us have an inventory of unsold developed lots totaling approximately 166,084 and 161,084 at December 31, 2012 and 2013, respectively. In addition, approximately 481 acres are available for future development. We anticipate having a sufficient inventory of lots to maintain our property sales for the foreseeable future. The specialized nature of our business requires that our facilities be well-maintained. Management believes we currently meet this standard.

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The following table sets forth certain information as of December 31, 2013, regarding our properties used by the funeral home segment and by the cemetery segment identified by state:

State	Number of Funeral Homes		Number of Cemeteries	
	Owned	Leased ⁽¹⁾	Owned	Managed
California	21	7	4	—
Connecticut	8	2	—	—
Florida	6	10	6	3
Georgia	5	—	—	—
Idaho	5	1	3	—
Illinois	2	2	1	—
Kansas	2	—	—	—
Kentucky	9	2	1	—
Maryland	1	—	—	—
Massachusetts	12	—	—	—
Michigan	3	—	—	—
Montana	2	1	1	—
Nevada	2	—	2	1
New Jersey	4	1	—	—
New Mexico	1	—	—	—
New York	2	—	—	—
North Carolina	3	1	1	—
Ohio	5	—	—	—
Oklahoma	6	—	2	—
Pennsylvania	1	—	—	—
Rhode Island	4	—	—	—
Tennessee	4	—	—	—
Texas	17	1	7	—
Virginia	3	1	—	—
Washington	1	1	—	—
West Virginia	1	1	—	—
Total	130	31	28	4

The leases, with respect to these funeral homes, generally have remaining terms ranging from one to eight years, (1) 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, 2013, we owned and operated 676 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, we believe that the reserves and our insurance provide reasonable coverage for known asserted and

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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:

2013	High	Low
First Quarter	\$21.25	\$12.90
Second Quarter	\$21.63	\$16.60
Third Quarter	\$19.40	\$17.36
Fourth Quarter	\$20.44	\$17.20
2012	High	Low
First Quarter	\$7.59	\$5.40
Second Quarter	\$8.59	\$6.91
Third Quarter	\$10.40	\$7.65
Fourth Quarter	\$11.99	\$9.26

As of February 28, 2014, there were 18,243,722 shares of our common stock outstanding and the closing price as reported by the New York Stock Exchange was \$20.43 per share. The shares of common stock outstanding are held by approximately 530 stockholders of record. Each share is entitled to one vote on matters requiring the vote of stockholders. We believe there are approximately 5,000 beneficial owners of our common stock.

DIVIDENDS

Our Board declared four quarterly dividends of \$0.025 per share, totaling approximately \$1.8 million, which were paid on March 1, 2013, June 3, 2013, September 3, 2013 and December 2, 2013, respectively, to record holders of our common stock as of February 13, 2013, May 16, 2013, August 14, 2013 and November 12, 2013, respectively. Prior to June 1, 2011, we had never paid cash dividends on our common stock. We intend to pay dividends in 2014.

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 SECURITIES BY THE ISSUER

In May 2012, our Board approved an increase to the share repurchase program authorizing us to purchase an additional \$3 million of our common stock up to an aggregate of \$8 million. The repurchases are to be executed in the open market and through privately negotiated transactions subject to market conditions, normal trading restrictions and other relevant factors. In 2011 we repurchased 126,952 shares of our common stock at an aggregate cost of \$736,456 and an average share price of \$5.82. In 2012, we repurchased 686,208 shares of our common stock at an aggregate cost of \$4.5 million and an average share price of \$6.60. If 2012 purchases were made in the first half of the year. We did not repurchase any shares of our common stock in the year ended December 31, 2013. The repurchased shares are held as Treasury stock.

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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 2008, and that all dividends were reinvested. Performance data for Carriage Services, Inc., 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 or the Exchange Act, 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, 2008 in stock or index, including reinvestment of dividends.

Fiscal year ending December 31. Peer Group includes SCI and StoneMor.

	12/08	12/09	12/10	12/11	12/12	12/13
Carriage Services, Inc.	\$100.00	\$195.52	\$241.29	\$282.32	\$606.03	\$1,002.94
Russell 3000	100.00	128.34	150.07	151.61	176.49	235.71
Peer Group	100.00	171.70	188.76	231.58	294.41	392.38

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, 2009, 2010, 2011, 2012 and 2013. 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,				
	2009	2010	2011	2012	2013
	(dollars in thousands, except per share amounts)				
INCOME STATEMENT DATA:					
Revenues:					
Funeral	\$126,459	\$133,734	\$141,112	\$152,004	\$163,965
Cemetery	43,197	43,783	42,402	47,388	49,992
Total revenues	169,656	177,517	183,514	199,392	213,957
Gross profit:					
Funeral	37,774	37,321	41,401	46,886	48,973
Cemetery	7,172	9,065	9,536	13,256	15,408
Total gross profit	44,946	46,386	50,937	60,142	64,381
General and administrative expenses	15,989	16,793	22,745	23,458	27,378
Operating income	28,957	29,593	28,192	36,684	37,003
Interest expense	(18,299)	(18,246)	(18,089)	(17,088)	(12,622)
Litigation settlement	—	—	—	—	—
Gain on repurchase of junior subordinated debentures	—	317	846	—	—
Loss on early extinguishment of debt and other costs	(180)	—	(201)	(3,031)	—
Interest and other income	228	751	52	963	81
Income before income taxes	10,706	12,415	10,800	17,528	24,462
Provision for income taxes	(4,336)	(4,954)	(4,590)	(6,960)	(9,277)
Net income from continuing operations	6,370	7,461	6,210	10,568	15,185
Income from discontinued operations	678	618	768	835	4,111
Preferred stock dividend	14	14	14	14	4
Net income	\$7,034	\$8,065	\$6,964	\$11,389	\$19,292
Earnings per share					
Basic:					
Continuing operations	\$0.36	\$0.42	\$0.34	\$0.58	\$0.83
Discontinued operations	0.04	0.04	0.04	0.05	0.23
Basic earnings per share	\$0.40	\$0.46	\$0.38	\$0.63	\$1.06
Diluted:					
Continuing operations	\$0.36	\$0.42	\$0.34	\$0.58	\$0.82
Discontinued operations	0.04	0.03	0.04	0.05	0.18
Diluted earnings per share	\$0.40	\$0.45	\$0.38	\$0.63	\$1.00
Dividends declared per share	\$—	\$—	\$0.075	\$0.10	\$0.10
Weighted average number of common and common equivalent shares outstanding:					
Basic	17,573	17,635	18,359	18,126	17,826
Diluted	17,749	17,938	18,397	18,226	22,393
OPERATING AND FINANCIAL DATA:					
Funeral homes at end of period	138	147	159	167	161
Cemeteries at end of period	32	33	33	33	32
Funeral services performed	23,010	24,585	26,415	28,028	29,996
Preneed funeral contracts sold	5,522	6,389	7,040	6,844	8,183
Backlog of preneed funeral contracts	72,172	79,842	81,030	81,585	80,714

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Average revenue per funeral contract	\$5,408	\$5,348	\$5,274	\$5,359	5,370
Cremation rate	40.6	% 43.0	% 45.1	% 46.1	% 46.8
Depreciation and amortization	\$10,199	\$9,849	\$9,479	\$9,948	\$11,668
BALANCE SHEET DATA:					
Total assets	\$619,298	\$671,012	\$672,777	\$738,085	\$746,599
Working capital	12,004	2,535	(1,097)	(9,036)	(11,503)
Long-term debt, net of current maturities	131,898	132,416	135,000	163,541	142,542
Convertible junior subordinated debenture	93,750	92,858	89,770	89,770	89,770
Stockholders' equity	108,222	119,673	126,778	134,818	155,973

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

OVERVIEW

General

We operate two types of businesses: funeral homes, which account for approximately 75% of our revenues, and cemeteries, which account for approximately 25% of our revenues. Funeral homes are principally a service business that provide funeral services (traditional burial and cremation) and sell related merchandise, such as caskets and urns. Cemeteries are primarily a sales business that sells interment rights (grave sites and mausoleum spaces) and related merchandise, such as markers and outer burial containers. At December 31, 2013, we operated 161 funeral homes in 26 states and 32 cemeteries in 10 states within the United States. Substantially all administrative activities are conducted in our home office in Houston, Texas.

We have implemented a long-term strategy in our operations designed to improve operating and financial results by growing market share and increasing profitability. We have a decentralized, entrepreneurial and local operating model that includes operating and financial standards developed from our best operations, along with an incentive compensation plan to reward Managing Partners for successfully meeting or exceeding the standards. The model essentially eliminated the use of line-item financial budgets at the location level in favor of the standards. The operating model and its standards, which we refer to as the “Standards Operating Model,” focus on the key drivers of a successful operation, organized around three primary areas - market share, people and operating financial metrics. The model and standards are the measures by which we judge the success of each business. In 2012, we began a five year incentive plan, called “Good to Great,” which reward business managers, known as “Managing Partners,” with a bonus at the end of five years, equal to a ratio of 4 to 6 times their average annual bonus, if they are able to achieve an annual compound growth rate of 2% over a five year period. To date, the Standards Operating Model has driven significant changes in our organization, leadership and operating practices. Most importantly, the Standards Operating Model has allowed us to measure the sustainable revenue growth and earning power of our portfolio businesses. The Standards Operating Model led to the development of our Strategic Acquisition Model, described below under “Acquisitions,” which guides our acquisition and disposition strategy. We expect both models to drive longer term, sustainable increases in market share, revenue, earnings and cash flow. The standards are not designed to produce maximum short-term earnings because we do not believe such performance is sustainable without ultimately stressing the business, which often leads to declining market share, revenues and earnings. Important elements of the Standards Operating Model include:

Balanced Operating Model – We believe a decentralized structure works best in the deathcare industry. Successful execution of the 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 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.

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.

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 volumes, including contracts from acquisitions, have increased from 23,010 in 2009 to 29,996 in 2013 (compound annual increase of 6.9%). Our funeral operating revenue, excluding financial revenue, has increased from \$120.6 million in 2009 to \$154.7 million in 2013 (compound annual increase of 6.4%). The increases are primarily a result of

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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 \$5.8 million in 2009 to \$9.3 million in 2013. We experienced a 1.6% increase in volumes in comparing the year ended December 31, 2013 to the year ended December 31, 2012 on a same store basis, while the average revenue per contract for the year ended December 31, 2013 decreased 1.2% compared to the year ended December 31, 2012. For the year ended December 31, 2013, funeral revenue from preneed commissions and preneed funeral trust earnings was \$9.3 million compared to \$7.6 million for the year ended December 31, 2012. The percentage of funeral services involving cremations has increased from 40.6% for the year ended December 31, 2009 to 46.8% for the year ended December 31, 2013. On a same store basis, the cremation rate has risen from 40.6% in 2009 to 46.0% for the year ended December 31, 2013. The cremation rate for our acquired funeral home businesses was 44.9% for the year ended 2009 compared to 49.4% for the year ended 2013.

Cemetery operating results are affected by the size and success of our sales organization. Approximately 47.0% of our 2012 cemetery revenues related to preneed sales of interment rights and related merchandise and services. For the year ended December 31, 2013, those preneed sales were approximately 48.0% of cemetery operating revenues. We believe that changes in the economy and consumer confidence affect the amount of preneed cemetery operating revenues. Cemetery revenues from investment earnings on trust funds grew from \$3.9 million in 2009 to \$9.5 million in 2013. Changes in the capital markets and interest rates affect this component of our cemetery revenues.

Our cemetery financial performance from 2009 through 2013 was characterized by varying levels of operating revenues yet increasing field-level cemetery profit margins. Cemetery operating revenue increased from \$39.3 million in 2009 to \$40.5 million in 2013 and increased 5.7% over 2012. 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 in 2014 is designed to expand our cemetery product offerings.

Financial Revenue

We market funeral and cemetery services and products on a preneed basis. 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 purchase of a life insurance policy, the proceeds of which will pay for such services at the time of need. Insurance policies, 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 as Preneed Insurance Commission within Funeral Revenue. 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).

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 as Preneed Cemetery Finance Charges within Cemetery Revenue. In substantially all cases, we receive an initial down payment at the time the contract is signed. 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.

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) 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 advisor (CSV RIA) or independent financial advisors. At December 31, 2013, CSV RIA provided these services to three institutions, which have custody of 78% of our trust assets, for a fee based on the market value of trust assets. Under state trust laws, we are allowed to charge the trust a fee for advising on the investment of the trust assets and these fees are recognized as income 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

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generate long-term investment returns without assuming undue risk, while ensuring the management of assets is in compliance with applicable laws.

Preneed funeral trust fund income earned, along with the receipt and recognition of any insurance benefits, are deferred until the service is performed. Applicable state laws generally require us to deposit a specified amount (which varies from state to state, generally 50% to 100% of selling price) into a merchandise and service trust fund for preneed cemetery merchandise and service sales. The related trust fund income earned is recognized when the related merchandise and services are delivered. 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 perpetual care trusts provides a portion of the funds necessary to maintain cemetery property and memorials in perpetuity. Perpetual care trust fund income is recognized, as earned, in our cemetery revenues.

The 2013 performance of our discretionary trust portfolio continued to benefit us through higher income earned from preneed funeral and cemetery contracts that have been serviced and through increased income from the cemetery perpetual care trusts. These benefits are evident in the increase in recognized financial revenue. Given the recurring nature of the income generated by our fixed income portfolio, we expect the performance of our discretionary trust portfolio to benefit us for the foreseeable future.

Our total discretionary portfolio performance of 14.2% exceeded the 80/20 index benchmark performance of 12.4% in 2013 due to each of the fixed income and equity components of our discretionary portfolio outperforming their respective benchmarks, S&P 500 and High Yield Index. Our discretionary portfolio equity and high yield performance in 2013 of 45% and 8.2%, respectively, exceeded the 32.4% for the S&P 500 and a 7.5% gain for the High Yield Index.

Acquisitions

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

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

In general terms, should a target business be acceptable per the criteria above, we will then determine the value of the target using a discounted cash flow methodology. During 2012, we acquired seven funeral home businesses and one cemetery business. The consideration paid for the 2012 acquisitions was \$42.7 million. We completed one acquisition during 2013 consisting of two funeral homes, one in Tennessee and one in Georgia. The consideration paid for this acquisition was \$13.7 million. Additionally, we purchased land for approximately \$6.0 million in 2013 to be used for future funeral expansions.

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 ("MD&A") is based upon our Consolidated Financial Statements presented herewith, which have been prepared in accordance with U.S. generally

accepted accounting principles (“GAAP”). Our significant accounting policies are more fully described in Part II, Item 8, Financial

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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 sales of funeral and cemetery merchandise and services when the merchandise is delivered or service is performed. Sales of cemetery interment rights are recorded as revenue in accordance with the retail land sales accounting principles. This method generally 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 real estate. Costs related to the sales of interment rights, which include property and other costs related to cemetery development activities, are charged to operations using the specific identification method in the period in which the sale of the interment right is recognized as revenue. Revenues to be recognized and cash flow from the delivery of merchandise and performance of services related to preneed contracts that were acquired in acquisitions are typically lower than those originated by us.

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 funeral services and merchandise are funded through third-party insurance policies, we earn a commission on the sale of the policies. Insurance commissions earned by us are recognized as revenue when the commission is no longer subject to refund, which is usually 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.

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. Goodwill is measured as a residual of the fair values at acquisition 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, assets or liabilities associated with the acquisition.

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

Debt Obligations

The outstanding principal of long-term debt at December 31, 2013 totaled \$159.7 million and consisted of \$117.0 million under our term loan, \$36.9 million outstanding under our revolving credit facility and \$5.8 million in acquisition indebtedness and capital lease obligations.

At December 31, 2013, we had a \$255 million secured bank credit facility (the "Credit Facility") with Bank of America, N.A. as Administrative Agent comprised of a \$125 million revolving credit facility and a \$130 million term loan. The Credit Facility also contains an accordion provision to borrow up to an additional \$40 million in revolving loans, subject to certain conditions. The Credit Facility matures on September 30, 2017 and is collateralized by all personal property and funeral home real property in certain states. Under the Credit Facility, outstanding borrowings bear interest at either a prime rate or a LIBOR rate, plus an applicable margin based upon the Company's leverage ratio. As of December 31, 2013, the prime rate margin was equivalent to 1.50% and the LIBOR margin was 2.50%. The weighted average interest rate on the Credit Facility for the year ended December 31, 2013 was 3.20%.

On April 24, 2013, we entered into a Third Amendment (the "Third Amendment") to our Credit Facility which increased the revolving credit commitments from \$105 million to \$125 million and decreased the interest rate margin for our outstanding borrowings (for both prime rate and LIBOR base rates) by 50 basis points at each leverage ratio threshold. Our Credit Facility also contains an accordion provision to borrow up to an additional \$40 million in revolving loans, subject to certain conditions. In connection with the Third amendment, we recorded a pre-tax charge of approximately \$0.4 million in second quarter of 2013 to write-off certain unamortized loan costs. Our Credit Facility matures on September 30, 2017 and is collateralized by all personal property and funeral home real property in certain states. We have the option to pay interest at either the prime rate or LIBOR rate plus a margin. At December 31, 2013, substantially all our borrowings under our Credit Facility were tied to the LIBOR rate.

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

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Goodwill

The excess of the purchase price over the fair value of identifiable net assets of funeral home businesses acquired is recorded as goodwill. Goodwill has primarily been recorded in connection with the acquisition of funeral businesses. Goodwill is tested for impairment by assessing the fair value of each of our reporting units. The funeral segment reporting units consist of 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, 2013.

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 2011 and 2012; however, for our 2013 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 testing, we compared the fair value of each reporting unit to its carrying value, including goodwill. We determined fair value for each reporting unit using both a market approach, weighted 70%, and an income approach, weighted 30%. Our methodology for determining a market approach fair value utilized recent sales transactions in the industry. 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 that may differ from actual future cash flows using a weighted average cost of capital for the Company and other public deathcare companies. Goodwill impairment is not recorded where the fair value of the reporting unit exceeds its carrying amount. If the fair value of the reporting unit is less than its carrying amount, the implied fair value of goodwill is compared to the carrying amount of the reporting unit's goodwill, and if the carrying amount exceeds the implied value, an impairment charge would be recorded in an amount equal to that excess.

In addition to our annual review, we assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may be greater than fair value. Factors that could trigger an interim impairment review include, but are not limited to, significant adverse changes in the business climate which may be indicated by a decline in our market capitalization or decline in operating results. No impairments were recorded in relation to our goodwill annual assessment in 2012 or 2013. No such events or changes occurred between the testing date and year end to trigger a subsequent impairment review. The West region has the greatest risk of failing the first step of the impairment test in the future. The fair value of the West region exceeded its carrying value by approximately 14%. As of December 31, 2013, \$60.7 million of goodwill was recorded in the West region. Should industry sales transactions suffer a decline in the multiple of earnings before interest, taxes, depreciation and amortization ("EBITDA") or the results of the West's operations decline in the future, the risk of goodwill impairment would increase.

In 2012 and 2013, we recognized impairments of approximately \$1.1 million and \$0.1 million, respectively, for locations held for sale as of December 31, 2012 and 2013. 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.

See Part II, Item 8, Financial Statements and Supplementary Data, Notes 1, 4 and 5 for additional information.

Intangible Assets

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

In addition to our annual review, we assess the impairment of intangible assets whenever events or changes in circumstances indicate that the carrying value may be greater than the fair value. Factors that could trigger an interim impairment review include, but are not limited to, significant under performance relative to historical results and significant negative industry or economic trends.

Long-Lived Assets

We review the carrying value of our long-lived assets for impairment whenever events or circumstances indicate that the carrying amount of the asset may not be recoverable, in accordance with the Property, Plant, and Equipment Topic of 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 changes in circumstances indicate that the carrying value may

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be greater than the fair value. We evaluate our long-lived assets for impairment when a funeral home business has negative EBITDA for consecutive years or there has been a decline in EBITDA for consecutive years. For our cemetery business, we analyze the long-lived assets for impairment if the business has a negative operating margin or a decline in operating margin over a multiple year period. We review our long-lived assets if deemed held for sale to the point of recoverability. 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, 2013, no impairments were identified.

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.

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

Income Taxes

We and our subsidiaries file a consolidated U.S. Federal income tax return and separate state income tax returns in 16 states in which we operate and combined or unitary income tax returns in 11 states in which we operate. We record deferred taxes for temporary differences between the tax basis and financial reporting basis of assets and liabilities. We record a valuation allowance to reflect the estimated amount of deferred tax assets for which realization is uncertain. Management reviews the valuation allowance at the end of each quarter and makes adjustments if it is determined that it is more likely than not that the tax benefits will be realized.

We analyze tax benefits for uncertain tax positions and how they are to be recognized, measured, and derecognized in 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. We have reviewed our income tax positions and identified certain tax deductions, primarily related to business acquisitions that are not certain. Our policy with respect to potential penalties and interest is to record them as “Other” expense and “Interest” expense, respectively. The entire balance of unrecognized tax benefits, if recognized, would affect our effective tax rate.

In July 2013, the Internal Revenue Service approved four tax accounting method changes which allowed additional tax deductions totaling \$57.2 million in our the year ended December 31, 2012. These deductions related to temporary differences previously recorded as deferred tax assets. The non-current deferred tax liability of approximately \$11.9 million recorded as of December 31, 2013 is primarily a result of us obtaining the benefit of such accounting changes while also utilizing net operating loss carryforwards arising from those changes against income from the current year. In September 2013, the U.S. Department of the Treasury and the Internal Revenue Service released final regulations relating to guidance on applying tax rules to amounts paid to acquire, produce or improve tangible personal property as well as rules for materials and supplies. The new guidance is required to be applied no later than our tax year beginning January 1, 2014. We are evaluating the future impact of the final regulations on our tax provision.

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

Stock Plans and Stock-Based Compensation

We have stock-based employee and director compensation plans in the form of restricted stock, stock options, performance awards and an employee stock purchase plan. 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.

Preneed Funeral and Cemetery Trust Funds

Our preneed and perpetual care trust funds are reported in accordance with principles of consolidating Variable Interest Entities (“VIEs”). In the case of preneed trusts, the customers are the legal beneficiaries. In the case of perpetual care trusts, we do not have a right to access the corpus in the perpetual care trusts. For these reasons, we have recognized financial interests of third parties in the trust funds in our Consolidated Balance Sheets 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 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 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.

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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 memorial sold. Income from the trust funds is distributed to us and is used to provide care and maintenance for the cemeteries and mausoleums. Such trust fund income is recognized as revenue when realized by the trust and distributable to us. We are restricted from withdrawing any of the principal balances of these funds.

An enterprise is required to perform an analysis to determine whether the enterprise's variable interest(s) give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has both the power to direct the activities of a VIE that most significantly impact the entity's economic performance and the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. Our analysis continues to support our position as the primary beneficiary in certain 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, 2013, CSV RIA provided these services to three institutions which have custody of 78% of our trust assets, for a fee based on the market value of trust assets. Under state trust laws, we are allowed to charge the trust a fee for advising on the investment of the trust assets and these fees are recognized as income in the period in which advisory 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 in Deferred preneed cemetery receipts held in trust or Deferred preneed funeral receipts held in trust. 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. Additional related disclosures are provided in Part II, Item 8, Financial Statements and Supplementary Data, Notes 6 and 10.

Fair Value Measurements

We define 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). 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 to disclose 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 Part II, Item 8, Financial Statements and Supplementary Data in Note 6 and 10. We currently do not have any assets that have fair values determined by Level 3 inputs. 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, 2013, 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 (i) the investor has the ability and intent to hold an investment and (ii) evidence indicating the cost of the investment is recoverable before we are more likely than not required to sell the investment. If impairment is indicated, then an adjustment will be made to reduce the carrying amount to fair value. As of December 31, 2013, no impairment has been identified.

In the ordinary course of business, we are typically exposed to a variety of market risks. Currently, these are primarily related to changes in fair market values related to outstanding debts and changes in the values of securities associated with the preneed and perpetual care trusts. Management is actively involved in monitoring exposure to market risk and developing and utilizing appropriate risk management techniques when appropriate and when available for a

reasonable price. The convertible junior subordinated debentures, payable to Carriage Services Capital Trust, pay interest at the fixed rate of 7% and are carried on our Consolidated Balance Sheets at a cost of approximately \$89.8 million, which approximates the fair value at December 31, 2013 based on Bloomberg Finance L.P.'s quotes for the corresponding preferred securities issued by the Trust.

For more information regarding fair value measurements, see Part II, Item 8, Financial Statements and Supplementary Data, Note 11.

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Computation of Earnings per Common Share

Basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share are 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 junior subordinated debentures.

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 prepare 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.

For the year ended December 31, 2013, the fully diluted weighted average shares outstanding, and the corresponding calculation of fully diluted earnings per share, include approximately 4.4 million shares that would be issued upon conversion of our convertible junior subordinated debentures as a result of the if-converted method prescribed by ASC 260. For the years ended December 31, 2011 and 2012, the conversion of our convertible junior subordinated debentures is excluded from fully diluted earnings per share calculations and the fully diluted weighted average share count because the inclusion of such converted shares resulted in an antidilutive impact.

The calculations for basic and diluted earnings per share for the three years ended December 31, 2011, 2012 and 2013 are presented in Part II, Item 8, Financial Statements and Supplementary Data, Note 20.

Subsequent Events

We have evaluated events and transactions during the period subsequent to December 31, 2013 through the date that the financial statements are issued for potential recognition or disclosure in the accompanying financial statements covered by this report. For more information regarding subsequent events, see Part II, Item 8, Financial Statement and Supplementary Data, Note 25.

RECENT ACCOUNTING PRONOUNCEMENTS, ACCOUNTING CHANGES AND OTHER REGULATION
Comprehensive Income

In February 2013, the Financial Accounting Standards Board (“FASB”) amended the Comprehensive Income Topic of the ASC to require reporting of amounts reclassified out of accumulated other comprehensive income (“AOCI”) by component. In addition, we are required to present significant amounts reclassified out of AOCI to net income in its entirety by the respective line items and to cross reference any disclosure elsewhere in the notes for amounts reclassified in less than their entirety. This amendment is effective prospectively for public companies for reporting periods after December 15, 2012. We adopted the provisions of this amendment effective January 1, 2013. See Part II, Item 8, Financial Statements and Supplementary Data, Note 17 for the appropriate disclosures.

Income Taxes

In July 2013, the FASB amended the Income Tax Topic of the ASC to eliminate the diversity in practice in the presentation of unrecognized tax benefits. The new guidance requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require an entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. This amendment is effective for the first annual or interim period beginning after December 15, 2013, thus effective for us beginning January 1, 2014. We will adopt the FASB’s amended guidance for our annual reporting period ending December 31, 2014. We do not anticipate the adoption of this amended guidance will have a significant impact on our financial position, results of operations or cash flows.

In September 2013, the U.S. Department of the Treasury and the Internal Revenue Service released final regulations relating to guidance on applying tax rules to amounts paid to acquire, produce or improve tangible personal property

as well as rules for materials and supplies. The new guidance is required to be applied no later than our tax year beginning January 1, 2014. We are evaluating the future impact of the final regulations on our tax provision.

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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,			
	2011	2012	2013	
Total revenues	100.0	% 100.0	% 100.0	%
Total gross profit	27.8	30.2	30.1	
General and administrative expenses	12.4	11.8	12.8	
Operating income	15.4	18.4	17.3	
Interest expense	9.9	8.6	5.9	

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,			
	2011	2012	2013	
Funeral homes at beginning of period	147	159	167	
Acquisitions	12	10	2	
Divestitures of existing funeral homes	—	(2	) (7)
Closure of funeral homes	—		(1)
Funeral homes at end of period	159	167	161	
Cemeteries at beginning of period	33	33	33	
Acquisitions	—	1	—	
Divestitures	—	(1	) (1)
Cemeteries at end of period	33	33	32	

YEAR ENDED DECEMBER 31, 2013 COMPARED TO YEAR ENDED DECEMBER 31, 2012

The following is a discussion of our results of operations for the years ended December 31, 2013 and 2012. The term “same store” or “existing operations” refers to funeral homes and cemeteries acquired prior to January 1, 2009 and owned and operated for the entirety of each period being presented. Funeral homes and cemeteries purchased after December 31, 2008 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.

Total revenue for the year ended December 31, 2013 was \$214.0 million compared to \$199.4 million for the comparable period of 2012, an increase of \$14.6 million, or 7.3%, and gross profit increased \$4.2 million, or 7.0%, from 2012 to 2013. Our acquired funeral businesses and cemetery businesses drove the overall revenues higher and contributed to the increase in gross profit in 2013 compared to 2012. Net income from continuing operations for the year ended December 31, 2013 totaled \$15.2 million, equal to \$0.82 per diluted share, as compared to \$10.6 million for the year ended December 31, 2012, or \$0.58 per diluted share. Net income for the year ended December 31, 2013 totaled \$19.3 million, equal to \$1.00 per diluted share as compared to \$11.4 million, or \$0.63 per diluted share, for the year ended December 31, 2012.

Total funeral home and cemetery gross margin was 30.1% in 2013 compared to 30.2% in 2012 and 27.8% in 2011. The gross profit margin translated into gross profit of \$64.4 million in 2013 compared to \$60.1 million in 2012 and \$50.9 million in 2011. The increase in gross profit was generally a result of our acquired businesses, better cemetery performance and increased trust earnings.

General and administrative expenses increased \$3.4 million, or 15.2%, in 2013 as compared to 2012, the majority of which was due to additional costs for upgrading our organizational overhead structure and talent in our corporate office and increased termination and consulting expenses.

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Income recognized from the investments in the preneed funeral trust funds, the cemetery merchandise and services trust funds and the perpetual care trust funds increased \$1.9 million, or 14.3% for the year ended December 31, 2013 as compared to 2012 as a result of higher income from fixed income securities and from capital gains recognized in the portfolios. For the five year period ended December 31, 2013, the performance of the funds, which includes realized income and unrealized appreciation, resulted in a 127.1% return. Investment income realized in the perpetual care trust funds (except for capital gains in certain states) 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. Because higher income has accumulated in the preneed trust funds, management expects increasing revenue in the future as the preneed contracts are delivered. In certain states, we are allowed to withdraw realized trust earnings prior to delivery from cemetery merchandise and services trusts, which management describes as “Withdrawable Trust Income.” The Withdrawable Trust Income, pre-tax, totaled \$1.9 million and \$1.5 million, respectively, for the years ended December 31, 2012 and 2013. While the Withdrawable Trust Income is not recognized as revenue in our Consolidated Statements of Operations, it increases cash flow from operations. The Withdrawable Trust Income is treated as a special item in our Non-GAAP presentation of net income calculation.

We also present our financial performance in our “Operating and Financial Metrics Trend Report” (“Trend Report”) as reported in our earnings release and discussed on our earnings call for the year ending December 31, 2013. 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 deathcare companies. The Trend Report is a Non-GAAP statement from continuing operations that also provides insight into underlying trends in our business. 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 GAAP.

The Non-GAAP financial measures in the Trend Report include “Adjusted Net Income,” “Adjusted Basic Earnings Per Share,” “Adjusted Diluted Earnings Per Share,” “Consolidated EBITDA,” “Adjusted Consolidated EBITDA,” “Funeral, Cemetery and Financial EBITDA,” “Total Field EBITDA” and “Special Items.” These financial measurements are defined as similar 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.carrigeservices.com). In addition, our presentation of these measures may not be comparable to similarly titled measures in other companies’ reports. We are providing below a reconciliation of net income from continuing operations (a GAAP measure) to Non-GAAP net income (a non-GAAP measure). Non-GAAP net income is defined as net income from continuing operations adjusted for Special Items, including Withdrawable Trust Income, acquisition expenses, severance costs and other items in the table below.

The adjustment of Special Items in Non-GAAP income allows management to focus on the evaluation of operating performance as it primarily relates to our operating expenses. The special items are tax effected at 34%. Non-GAAP income 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 deathcare companies. Similar to the Trend Report, 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 GAAP.

	Year Ended December 31,			
	2012		2013	
(In millions, except diluted EPS)	Net Income	Diluted EPS	Net Income	Diluted EPS
Net income from continuing operations, as reported	\$10.6	\$0.58	\$15.2	\$0.82
After-tax Special Items:				
Withdrawable trust income	1.3	0.07	1.0	0.05
Costs related to the Credit Facility	2.0	0.11	0.2	0.01
Acquisition and divestiture expenses	0.9	0.05	0.5	0.03
Severance costs	0.5	0.03	1.0	0.05
Consulting fees	—	—	0.4	0.02

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Litigation settlements and other related costs	(0.5)	(0.03)	—	—	
Other	—		—		(0.1)	—
Non-GAAP net income including Special Items	\$14.8		\$0.81		\$18.2		\$0.98
Diluted weighted average shares outstanding (in thousands)			18,226				22,393

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Funeral Home Segment. The following table sets forth certain information regarding our revenues and operating profit from the funeral home operations for the year ended December 31, 2012 compared to the year ended December 31, 2013.

	Year Ended December 31,		Change		
	2012	2013	Amount	Percent	
	(dollars in thousands)				
Revenues:					
Same store operating revenue	\$118,571	\$118,813	\$242	0.2	%
Acquired operating revenue	25,801	35,891	10,090	39.1	%
Preneed funeral insurance commissions	1,711	1,853	142	8.3	%
Preneed funeral trust earnings	5,921	7,408	1,487	25.1	%
Revenues from continuing operations	\$152,004	\$163,965	\$11,961	7.9	%
Operating profit:					
Same store operating profit	\$45,634	\$44,682	\$(952)	(2.1)	%)
Acquired operating profit	8,339	10,886	2,547	30.5	%
Preneed funeral insurance commissions	318	631	313	98.4	%
Preneed funeral trust earnings	5,906	7,356	1,450	24.6	%
Operating profit from continuing operations	\$60,197	\$63,555	\$3,358	5.6	%

Funeral home same store operating revenues for the year ended December 31, 2013 increased \$0.2 million, or 0.2%, when compared to the year ended December 31, 2012. We experienced an increase in the number of contracts year over year of 1.6%, yet the average revenue per contract for those existing operations decreased \$64 to \$5,462. The average revenue per contract includes the impact of the funeral trust fund earnings recognized at the time that we provide the services pursuant to the preneed contract. Excluding funeral trust earnings, the average revenue per contract decreased \$70 to \$5,215. The number of traditional burial contracts decreased 1.0%, while the average revenue per burial contract increased slightly to \$8,350. The cremation rate for the same store businesses rose from 44.6% in 2012 to 46.0% in 2013. The average revenue per cremation contract decreased 1.9% to \$3,029, and the number of cremation contracts increased 4.8%. Cremations with services have declined from 35.4% of total cremation contracts in the year ended 2012 to 32.3% in the year ended 2013. 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 7.2% of the total number of contracts in 2013, increased from \$2,104 in 2012 to \$2,246 in 2013. Same store operating profit for the year ended December 31, 2013 decreased \$1.0 million, or 2.1%, from the year ended December 31, 2012, and as a percentage of funeral same store operating revenue, decreased to 37.6% in 2013 from 38.5% in 2012. The decrease in same store operating profit was due primarily to an increase in salaries and benefits of approximately \$0.7 million and an increase in our self-insurance program for property, casualty and general liability risk of \$0.4 million offset by decreases in transportation costs and field general and administrative costs.

Funeral home acquired revenues for the year ended December 31, 2013 increased \$10.1 million, or 39.1%, when compared to the year ended December 31, 2012, as we experienced a 28.9% increase in the number of contracts and an increase of 8.4%, to \$5,077, in the average revenue per contract for those acquired operations. Excluding funeral trust earnings, the average revenue per contract increased 7.9% to \$4,975 in 2013 from \$4,612 in 2012. The number of traditional burial contracts increased 41.4%, and the average revenue per burial contract increased 5.3% to \$7,892. The cremation rate for the acquired businesses was 49.4% for 2013 compared to 52.1% in 2012. The average revenue per cremation contract increased 3.7% to \$3,119 for 2013, and the number of cremation contracts increased 22.3% compared to 2012. Cremations with services remained consistent at 34.5% and 34.8% for 2012 and 2013, respectively. The reason for the increase in average revenue per contract for acquired operations and the decline in the cremation rate is because the acquired businesses serve primarily traditional burial families.

Acquired operating profit for the year ended December 31, 2013 increased \$2.5 million, or 30.5%, from the year ended December 31, 2012 and, as a percentage of revenue from acquired funeral homes, decreased from 32.3% for 2012 to 30.3% for 2013. Salaries and benefits of acquired operations are generally higher as a percentage of revenue than existing locations. As these acquired businesses transition into our Standard Operating Model, we expect to see operating profit margins rise toward those on a same store basis.

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The two categories of financial revenue (insurance commissions and trust earnings on matured preneed contracts) on a combined basis, increased \$1.6 million in revenue and \$1.8 million in operating profit, respectively, for the year ended December 31, 2013 compared to the year ended December 31, 2012, as a result of higher earnings on trust contracts. Trust earnings also include trust management fees charged to our wholly-owned registered investment advisor based on the fair market value of the trust assets.

Cemetery Segment. The following table sets forth certain information regarding our revenues and operating profit from the cemetery operations for the year ended December 31, 2012 compared to the year ended December 31, 2013:

	Year Ended December 31,		Change Amount	Percent	
	2012	2013			
(dollars in thousands)					
Revenues:					
Same store operating revenue	\$38,113	\$40,181	\$2,068	5.4	%
Acquired operating revenue	166	298	132	n/a	
Cemetery trust earnings	7,647	8,095	448	5.9	%
Preneed cemetery finance charges	1,462	1,418	(44)	(3.0))%
Revenues from continuing operations	\$47,388	\$49,992	\$2,604	5.5	%
Operating Profit:					
Same store operating profit	\$9,897	\$11,757	\$1,860	18.8	%
Acquired operating profit	(76)	(43)	33	n/a	
Cemetery trust earnings	7,598	7,920	322	4.2	%
Preneed cemetery finance charges	1,462	1,418	(44)	(3.0))%
Operating profit from continuing operations	\$18,881	\$21,052	\$2,171	11.5	%

Cemetery same store operating revenues for the year ended December 31, 2013 increased \$2.1 million, or 5.4%, compared to the year ended December 31, 2012. The revenue increase was attributable to same store revenue from preneed property sales, which increased \$1.9 million, or 10.9%, due to an 11.8% increase in the number of interment rights (property) sold in 2013 as compared to 2012. The average price per interment decreased 1.0% to \$2,811 in 2013. The percentage of those interment rights sold that we were able to recognize as revenue, because we received at least 10% of the sales price from the customer, decreased from 94.1% in 2012 to 93.0% in 2013. Same store at-need revenue increased \$0.9 million, or 5.7%, while the number of at-need contracts increased slightly to 12,515 in 2013 from 12,501 in 2012. Revenue from deliveries of preneed merchandise and services decreased \$0.5 million, or 10.0% in 2013 as compared to 2012.

Cemetery same store operating profit for the year ended December 31, 2013 increased \$1.9 million, or 18.8%. As a percentage of revenues, cemetery same store operating profit increased from 26.0% in 2012 to 29.3% in 2013. The increase in operating profit is primarily a result of the increase in revenue while managing bad debt and promotional expenses against higher salaries and benefits.

We acquired one cemetery in the second quarter of 2012 which operates primarily as an at-need business. This is the only cemetery business in this category.

The two categories of financial revenue consist of trust earnings and finance charges on preneed receivables. Total trust earnings increased \$0.4 million, or 5.9%, when compared to the year ended December 31, 2012. Earnings from perpetual care trust funds totaled \$5.6 million for the year ended December 31, 2013 compared to \$6.0 million for the year ended December 31, 2012, a decrease of \$0.4 million, or 7.1%. The decrease in perpetual care trust earnings is due to lower interest income earned in 2013 as compared to 2012 and the divestiture of one of our cemetery businesses in July 2013. Trust earnings recognized upon the delivery of merchandise and service contracts increased \$0.4 million, or 28.0%, to \$1.6 million in 2013 as compared to the same period in 2012. Trust earnings also include trust management fees charged by our wholly-owned registered investment advisor based on the fair market value of the trust assets. Finance charges on the preneed contracts decreased 3.0% year over year.

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Regional and Unallocated Funeral and Cemetery Costs. Regional and unallocated funeral and cemetery costs consist of salaries and benefits for regional management, field incentive compensation and other related costs for field infrastructure. Regional and unallocated funeral and cemetery costs increased slightly to \$10.0 million for the year ended December 31, 2013 due primarily to an increase in incentive compensation of \$0.1 million and an increase of \$0.5 million in regional training and meetings, offset by lower regional fixed costs.

General and Administrative. General and administrative expenses totaled \$25.9 million for the year ended December 31, 2013, an increase of \$3.4 million or 15.2%, compared to the year ended December 31, 2012 primarily due to \$2.1 million of additional costs for upgrading our organizational overhead structure and talent in our corporate office, a \$1.0 million increase in termination and consulting expenses and \$0.2 million related to a non-recurring securities transaction fee.

Total Interest and other, net. Total interest and other, net totaled \$12.5 million for the year ended December 31, 2013 compared to \$19.2 million for the year ended December 31, 2012 for a decrease of \$6.6 million, or 34.5%, due primarily to lower interest rates on our Credit Facility in 2013 which decreased interest expense by approximately \$3.7 million. Additionally, we incurred a \$3.0 million loss on the early extinguishment of debt in 2012 that did not occur in 2013.

Income taxes. See Part II, Item 8, Financial Statements and Supplementary Data, Note 16 for a discussion of income taxes for 2012 and 2013.

YEAR ENDED DECEMBER 31, 2012 COMPARED TO YEAR ENDED DECEMBER 31, 2011

The following is a discussion of our results of operations for the years ended December 31, 2012 and 2011 as it was presented on a historical basis at December 31, 2012. The term “same store” or “existing operations” refers to funeral homes and cemeteries acquired prior to January 1, 2007 and owned and operated for the entirety of each period presented. Funeral homes and cemeteries purchased after January 1, 2007 are referred to as “acquired.” This classification of acquisitions has been important to management and investors in monitoring the results of these businesses and gauging the leveraging performance contribution that a selective acquisition program can have on our total performance. Depreciation and amortization and regional and unallocated funeral and cemetery costs are not included in operating profit. This presentation of acquired operations included seven businesses acquired during 2007 and the presentation of same store operations included four businesses that were discontinued in 2012.

Total revenue for the year ended December 31, 2012 was \$204.1 million, an increase of 8.8%, compared to \$187.7 million for the comparable period in 2011 and gross profit increased \$9.8 million, or 18.8% from 2011 to 2012. Our acquired businesses drove the overall revenues higher, and both existing and acquired business contributed to the higher increase in gross profit in 2012 compared to 2011. Operating income declined by \$9.1 million from 2011 to 2012 due to margin growth from our acquisitions, existing funeral home businesses and financial profit. Net income from continuing operations for the year ended December 31, 2012 totaled \$11.6 million, equal to \$0.64 per diluted share as compared to \$6.8 million for the year ended December 31, 2011, or \$0.37 per diluted share. Net income for the year ended December 31, 2012 totaled \$11.4 million, equal to \$0.63 per diluted share, as compared to \$7.0 million, or \$0.38 per diluted share, as we had income from discontinued operations in 2011 and a loss in 2012.

Total funeral home and cemetery gross margin results improved in 2012 compared to 2011 as the gross profit margin rose to 30.3% in 2012 compared to 27.7% in 2011 and 26.1% in 2010. The increased gross profit margin translated into gross profit of \$61.9 million in 2012 compared to \$52.1 million in 2011 and \$47.4 million in 2010. The improvement was primarily due to our acquisitions.

General and administrative expenses increased \$0.7 million in 2012 compared to 2011, the majority of which was due to hiring additional personnel within our national cemetery and preneed operations and increased incentive compensation.

Another source of increasing revenue and gross profit is the income recognized from the investments in the preneed funeral trust funds, the cemetery merchandise and services trust funds and the perpetual care trust funds. There was a major reallocation of investments that began in the latter half of 2008, which led to increasing revenue over the four year period ending December 31, 2012 as a result of substantially higher income from fixed income securities and from capital gains recognized in the portfolios. For the four year period ended December 31, 2012, the performance of the funds, which includes realized income and unrealized appreciation, resulted in a 99.8% return. Investment income

realized in the perpetual care trust funds (except for capital gains in certain states) 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 accounts and deferred from revenue until the time that the service and merchandise are delivered to the customer. Because higher income has accumulated in the preneed trust funds, management expects to see increasing revenue in the future as the preneed contracts are delivered. The increase in revenues from trust earnings from 2011 to 2012 totaled \$3.2 million and

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the increase in revenues from trust earnings from 2010 to 2011 totaled \$0.6 million. The increase in 2012 was due to an increase in realized interest income in our perpetual care accounts and increased earnings from delivered preneed contracts.

In certain states, we are allowed to withdraw realized trust earnings prior to delivery from cemetery merchandise and service trusts, which management describes as "Withdrawable Trust Income." The Withdrawable Trust Income totaled \$4.5 million and \$1.9 million, respectively, for the years ended December 31, 2011 and 2012. The year over year decline was attributable to substantial gains realized in the trust funds throughout 2011 that was not repeated in 2012. While the Withdrawable Trust Income is not recognized as revenue in our consolidated statements of operations in the year withdrawn, but it is considered deferred revenue and it increases cash flow from operations. The Withdrawable Trust Income is treated as a special item in our Non-GAAP presentation of net income and diluted earnings per share. We are providing below a reconciliation of net income from continuing operations (a GAAP measure) to Non-GAAP net income (a non-GAAP measure). Non-GAAP net income is defined as net income from continuing operations, adjusted for special items, including Withdrawable Trust Income, acquisition expenses and the other items in the table below. The special items below are tax effected at 39.7%. Non-GAAP net income is used as a supplemental financial measurement by management and investors to compare our current financial performance with our previous results and with the performance of other deathcare companies. The adjustment of special items in Non-GAAP income allows management to focus on the evaluation of operating performance as it primarily relates to our operating expenses. 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 GAAP.

(In millions, except diluted EPS)	Year Ended December 31,			
	2011 Net Income	Diluted EPS	2012 Net Income	Diluted EPS
Net income from continuing operations, as reported	\$6.8	\$0.37	\$11.6	\$0.64
After-tax Special Items:				
Withdrawable trust income	2.6	0.15	1.2	0.06
Additional interest and other costs of Credit Facility	0.1	0.01	1.8	0.10
Acquisition expenses	0.7	0.04	0.8	0.04
Severance costs	1.1	0.06	0.5	0.03
Other professional fees	0.1	0.01	—	—
Litigation settlements and other related costs	—	—	0.1	0.01
Reduction of litigation reserve	—	—	(0.5	) (0.03
Stock performance based incentive executive compensation	0.6	0.03	—	—
Gain on repurchase of convertible junior subordinated debentures	(0.5	) (0.03) —	—
Securities transactions expenses	0.3	0.01	—	—
Non-GAAP net income including Special Items	\$11.8	\$0.65	\$15.5	\$0.85
Diluted weighted average shares outstanding (in thousands)		18,397		18,226

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Funeral Home Segment. The following table sets forth certain information regarding our revenues and operating profit from the funeral home operations for the year ended December 31, 2011 compared to the year ended December 31, 2012:

	Year Ended		Change		
	December 31, 2011	2012	Amount	Percent	
(dollars in thousands)					
Revenues:					
Same store operating revenue	\$120,766	\$120,576	(190)	(0.2))%
Acquired operating revenue	14,210	25,802	11,592	81.6	%
Preneed funeral insurance commissions	1,811	1,711	(100)	(5.5))%
Preneed funeral trust earnings	6,357	5,968	(389)	(6.1))%
Revenues from continuing operations	\$143,144	\$154,057	\$10,913	7.6	%
Operating profit:					
Same store operating profit	\$43,288	\$46,231	\$2,943	6.8	%
Acquired operating profit	3,681	8,339	4,658	126.5	%
Preneed funeral insurance commissions	435	304	(131)	(30.1))%
Preneed funeral trust earnings	6,357	5,968	(389)	(6.1))%
Operating profit from continuing operations	\$53,761	\$60,842	\$7,081	13.2	%

Funeral home same store operating revenues for the year ended December 31, 2012 decreased \$0.2 million, or 0.2% when compared to the year ended December 31, 2011. We experienced a decline in the number of contracts year over year of 1.4% and the average revenue per contract for those existing operations increased \$40 to \$5,537. The average revenue per contract includes the impact of the funeral trust fund earnings recognized at the time that we provide the needed services for preneed families. Excluding funeral trust earnings, the average revenue per contract increased \$65 to \$5,297. The number of traditional burial contracts decreased 4.6%, while the average revenue per burial contract increased 2.7% to \$8,318. The cremation rate for the same store businesses rose from 42.7% to 44.5%. The average revenue per cremation contract increased 0.5% to \$3,084, and the number of cremation contracts increased 2.6%. Cremations with services have declined from 39.0% of total cremation contracts in the year ended 2011 to 35.2% in the year ended 2012. The average revenue for "other" contracts, which make up approximately 7.3% of the number of contracts, increased from \$2,041 to \$2,112. Other contracts consist of charges for merchandise or services for which we do not perform a funeral service for the deceased during the period.

Same store operating profit for the year ended December 31, 2012 increased \$2.9 million, or 6.8%, from the comparable year ended December 31, 2011, and as a percentage of funeral same store operating revenue, increased from 35.8% to 38.3% as we have seen operating expenses decrease in the year ended December 31, 2012. We have experienced decreases in most same store controllable expense categories, including \$2.4 million in salaries, wages and benefit costs and \$0.2 million in transportation costs for the year ended December 31, 2012, when compared to the year ended December 31, 2011. Our costs for the self-insurance program for property, casualty and general liability risk also increased by approximately \$0.3 million year over year.

Funeral home acquired revenues for the year ended December 31, 2012 increased \$11.6 million, or 81.6%, when compared to the year ended December 31, 2011, as we experienced a 52.6% increase in the number of contracts, due in large part to the acquisitions completed in 2012 and 2011, and an increase of 18.9%, to \$4,685, in the average revenue per contract for those acquired operations. Excluding funeral trust earnings, the average revenue per contract increased 19.0% year over year. The cremation rate for the acquired businesses was 52.1% for 2011, compared to 59.4% in the prior year. The average revenue per cremation contract increased 8.9% to \$3,007 for 2012, and the number of cremation contracts increased 33.8% compared to 2011.

Acquired operating profit for the year ended December 31, 2012 increased \$4.7 million, or 126.5%, from the year ended December 31, 2011 and, as a percentage of revenue from acquired funeral homes, increased from 25.9% for

2011 to 32.3% for 2012. As these acquired businesses transition into our Standard Operating Model, we expect to see operating profit margins rise toward those on a same store basis.

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The two categories of financial revenue, insurance commissions and trust earnings on matured preneed contracts, on a combined basis, decreased \$0.5 million in both revenue and operating profit compared to the year ended December 31, 2011, primarily due to a reduction in earned insurance commissions as we increased sales of preneed funeral trust contracts in 2012.

Cemetery Segment. The following table sets forth certain information regarding our revenues and operating profit from the cemetery operations for the year ended December 31, 2011 compared to the year ended December 31, 2012:

	Year Ended		Change		
	December 31, 2011	2012	Amount	Percent	
	(dollars in thousands)				
Revenues:					
Same store operating revenue	\$38,152	\$39,902	\$1,750	4.6	%
Acquired operating revenue	—	166	166	n/a	
Cemetery trust earnings	5,041	8,506	3,465	68.7	%
Preneed cemetery finance charges	1,341	1,518	177	13.2	%
Revenues from continuing operations	\$44,534	\$50,092	\$5,558	12.5	%
Operating Profit:					
Same store operating profit	\$9,525	\$10,176	\$651	6.8	%
Acquired operating profit	—	(76)	(76)	n/a	
Cemetery trust earnings	5,041	8,457	3,416	67.8	%
Preneed cemetery finance charges	1,341	1,518	177	13.2	%
Operating profit from continuing operations	\$15,907	\$20,075	\$4,168	26.2	%

Cemetery same store operating revenues for the year ended December 31, 2012, increased \$1.8 million, or 4.6%, compared to the year ended December 31, 2011. The revenue increase was attributable to same store revenue from preneed property sales, which increased \$0.9 million, or 5.4%, due to a 0.7% increase in the number of interment rights (property) sold and a 6.2% increase in the average price per interment compared to 2011. Revenues from deliveries of preneed merchandise and services increased \$0.2 million, or 3.6%. Same store at-need revenues increased \$0.2 million, or 1.5%.

Cemetery same store operating profit for the year ended December 31, 2012 increased \$0.6 million, or 6.8%. As a percentage of revenues, cemetery same store operating profit slightly increased from 25.0% to 25.5%, as a result of increased revenues. Promotional expenses (primarily preneed sales commissions) increased \$0.9 million, preneed property costs increased \$0.3 million and bad debt increased \$0.3 million. These changes caused the preneed margin to decrease 380 basis points to 45.6%. Overall, controllable expenses such as salaries and benefits, transportation, and general and administrative costs decreased \$0.2 million, or 1.3%, and the costs of the self-insurance program for property, casualty and general liability risks increased \$0.1 million, or 33.1%.

Cemetery acquired operating revenues and acquired operating profit for the year ended December 31, 2012 are the result of an acquisition during the second quarter.

The two categories of financial revenue consist of trust earnings and finance charges on preneed receivables. Trust earnings increased \$3.5 million, or 68.7%, when compared to the year ended December 31, 2011. Earnings from perpetual care trust funds totaled \$6.7 million for the year ended December 31, 2012, compared to \$3.6 million for the year ended December 31, 2011, an increase of \$3.0 million, or 82.9%. The increase in perpetual care trust earnings is due to higher interest income earned in 2012 compared to 2011. Trust earnings recognized upon the delivery of merchandise and service contracts increased \$0.1 million, or 5.7% to \$1.5 million, compared to the same period in 2011. Higher trust income and capital gains realized in recent years in the merchandise and services trusts have been allocated to the preneed contracts which are providing higher income to recognize upon delivery. Finance charges on the preneed contracts decreased \$0.2 million or 13.2% year over year due to the increase in overall preneed sales and preneed receivables.

Other. General and administrative expenses totaled \$22.5 million for the year ended December 31, 2012, an increase of \$0.8 million compared to the year ended December 31, 2011. We incurred \$0.8 million of additional costs due to the expansion and upgrade of talent in our national cemetery and preneed organization and \$2.4 million increase in incentive compensation cost. In 2011, we had \$1.1 million of additional termination expenses in connection with the reorganization of management,

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\$0.8 million of incentive compensation costs for a non-recurring performance based plan and \$0.5 million related to a non-recurring securities transaction.

Interest income and other, net for the year ended December 31, 2012 is primarily a reduction in litigation reserve that management believes future costs are immaterial.

Income taxes. See Note 16 to the Consolidated Financial Statements for a discussion of the income taxes for 2012 and 2011.

LIQUIDITY AND CAPITAL RESOURCES**Overview**

Our primary sources of liquidity and capital resources are internally generated cash flows from operating activities and availability under our Credit Facility (as defined below under Debt Obligations). We generate cash in our operations primarily from at-need sales and delivery of preneed sales. We also generate cash from earnings on our cemetery perpetual care trusts. We believe that existing cash balances, future cash flows from operations and borrowings under our Credit Facility will be sufficient to meet our anticipated working capital requirements, capital expenditures, scheduled debt payments, commitments, dividend payments and acquisitions for the foreseeable future. Based on our recent operating results, current cash position, anticipated future cash flows and sources of financing that we expect to have available, we do not anticipate any significant liquidity constraints in the foreseeable future. However, if our capital expenditures or acquisition plans for 2014 change, we may need to access the capital markets to obtain additional funding. Further, to the extent operating cash flow or access to and cost of financing sources are materially different than expected, future liquidity may be adversely affected.

Cash Flows

We began 2013 with \$1.7 million in cash and other liquid investments and ended the year with \$1.4 million in cash and \$36.9 million drawn on our revolving credit facility. The elements of cash flow for the years ended December 31, 2013 and 2012 consisted of the following (in millions):

	2012	2013
Cash at beginning of year	\$1.1	\$1.7
Cash flow from operating activities	25.8	39.8
Cash used for acquisitions and new construction	(45.1)	)(19.7)
Cash from sale of businesses and other assets	0.6	10.2
Borrowings (payments) on our Credit Facility and long-term debt obligations, net	40.1	(19.0)
Cash used for maintenance capital expenditures	(5.0)	)(6.6)
Cash used for growth capital expenditures	(5.4)	)(4.1)
Cash used for dividends on common stock and redeemable preferred stock	(1.8)	)(1.8)
Cash used for loan origination costs and call premium of our Senior Notes	(4.9))—
Cash used for the purchase of common stock	(4.5))—
Other investing and financing activities, net	0.8	0.9
Cash at end of year	\$1.7	\$1.4

For the year ended December 31, 2013, cash provided by operating activities was \$39.8 million, as compared to \$25.8 million for the year ended December 31, 2012. The increase was primarily due to an increase in net income, cash earned on delivered contracts and other favorable working capital changes, offset by a gain on sale of divested businesses.

Our investing activities resulted in a net cash outflow of approximately \$20.2 million for the year ended December 31, 2013 compared to a net cash outflow of approximately \$55.0 million for the year ended December 31, 2012. The decrease in cash outflows from investing activities was primarily due to payments for acquisitions and new construction of approximately \$19.7 million in the year ended December 31, 2013 compared to \$45.1 million in the year ended December 31, 2012. During 2013, we completed one acquisition consisting of two funeral homes for approximately \$13.7 million. During 2012, we completed seven acquisitions of funeral home businesses, including a cemetery business, for \$42.7 million. We acquired land for approximately \$6.0 million and \$2.4 million in the years ended December 31, 2013 and 2012, respectively, for funeral home expansion projects. Additionally, we had net

proceeds from the sales of businesses and other assets of \$10.2 million in the 2013 period compared to \$0.6 million in the 2012 period.

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For the year ended December 31, 2013, total capital expenditures totaled \$10.7 million compared to \$10.4 million for the year ended December 31, 2012. Maintenance capital expenditures were \$6.6 million for the year ended December 31, 2013 compared to \$5.0 million for the year ended December 31, 2012. The increase in maintenance capital expenditures for the year ended December 31, 2013 was primarily due to an increase in vehicle purchases of \$0.5 million, information technology and infrastructure improvements of \$0.3 million and other funeral home and cemetery major repair projects of \$0.5 million.

Our financing activities resulted in a net cash outflow of \$20.0 million for the year ended December 31, 2013 compared to a net cash inflow of \$29.8 million for the year ended December 31, 2012. During the year ended December 31, 2013, we repaid \$7.8 million under our Credit Facility, whereas we borrowed \$43.3 million in the year ended December 31, 2012. Cash flows from financing activities for the year ended December 31, 2012 was partially offset by the purchase of \$4.5 million in treasury stock and the payment of loan origination costs and the call premium associated with our senior notes redemption of \$4.9 million.

Annually, we spend approximately \$10 - \$13 million on capital expenditures and we plan to acquire funeral and cemetery businesses in 2014 and future years. We spent \$18.6 million, \$45.1 million and \$19.7 million on acquisitions, including land purchases, in 2011, 2012 and 2013, respectively. Our Credit Facility provides us the flexibility to fund working capital, capital expenditures, acquisitions and other capital needs.

Dividends

Our Board declared four quarterly dividends of \$0.025 per share, totaling approximately \$1.8 million, which were paid on March 1, 2013, June 3, 2013, September 3, 2013 and December 2, 2013, respectively, to record holders of our common stock as of February 13, 2013, May 16, 2013, August 14, 2013 and November 12, 2013, respectively. We have a dividend reinvestment program so that stockholders may elect to reinvest their dividends into additional shares of our common stock.

Debt Obligations

As of December 31, 2013, we had a \$255 million Credit Facility with Bank of America, N.A. as the Administrative Agent comprised of a \$125 million revolving credit facility and a \$130 million term loan. Our Credit Facility also contains an accordion provision to borrow up to an additional \$40 million in revolving loans, subject to certain conditions. Our Credit Facility is set to mature on September 30, 2017 and is collateralized by all personal property and funeral home real property in certain states. As of December 31, 2013, \$36.9 million was drawn under the revolving credit facility and \$117.0 million was outstanding under the term loan. No letters of credit were issued and outstanding under our Credit Facility at December 31, 2013. Under our Credit Facility, outstanding borrowings bear interest at either a prime rate or a LIBOR rate, plus an applicable margin based upon the Company's leverage ratio. At December 31, 2013, the prime rate margin was equivalent to 1.50% and the LIBOR margin was 2.50%. The weighted average interest rate on our Credit Facility for the year ended December 31, 2013 was approximately 3.20%.

On April 24, 2013, we entered into a third amendment to our Credit Facility (the "Third Amendment"), which increased the revolving credit commitments under our Credit Facility from \$105 million to \$125 million and decreased the interest rate margin. The Third Amendment decreases the applicable margin for the Company's outstanding borrowings (for both prime rate and LIBOR base rates) by 50 basis points at each leverage ratio threshold.

The Third Amendment also contains amendments which (a) allows us to issue subordinated debt or convertible subordinated debt in an amount not to exceed \$100 million, (b) provides us with the ability to repurchase up to \$15 million worth of stock-based employee awards, and (c) allows us to refinance our existing convertible junior subordinated debentures with the proceeds of certain issuances of subordinated debt or convertible subordinated debt.

The outstanding principal balance of our long-term debt and capital lease obligations totaled \$159.7 million at December 31, 2013 and consisted of \$117.0 million under our term loan, \$36.9 million outstanding under our revolving credit facility and \$5.8 million in acquisition indebtedness and capital lease obligations.

A total of \$89.8 million was outstanding at December 31, 2013 under the convertible junior subordinated debentures. Amounts outstanding under the debentures are payable to our affiliated trust, Carriage Services Capital Trust (the "Trust"), bear interest at 7.0% and mature in 2029. Substantially all the assets of the Trust consist of the convertible junior subordinated debentures. In 1999, the Trust issued 1.875 million shares of 7% convertible preferred securities, termed "TIDES." The rights under the debentures are functionally equivalent to those of the TIDES.

The convertible junior subordinated debentures payable to the affiliated Trust, and the TIDES, each contain a provision for the deferral of interest payments and distributions for up to 20 consecutive quarters. During any period in which distribution payments are deferred, distributions will continue to accumulate at the 7% annual rate. Also, the deferred distributions themselves accumulate distributions at the annual rate of 7%. During any deferral period, we are prohibited from paying

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dividends on common stock or repurchasing common stock, subject to limited exceptions. We currently expect to continue paying the distributions as due.

We were in compliance with the covenants contained in our Credit Facility as of December 31, 2013. Key ratios that we must comply with include a Total Debt to EBITDA ratio that as of the last day of each quarter must not be greater than 3.75 to 1.00 through September 30, 2014 and no more than 3.50 to 1.00 thereafter and a fixed charge coverage ratio that must not be less than 1.20 to 1.00. As of December 31, 2013, the leverage ratio was 2.83 to 1.00 and the fixed charge coverage ratio was 2.01 to 1.00. The leverage ratio decline to below 3.00 to 1.00 at June 30, 2013 automatically triggered a 50 basis point rate decline on all our term loan and revolving credit facility during the third quarter of 2013.

In May 2012, our Board approved an increase to the share repurchase program authorizing the Company to purchase an additional \$3.0 million of our common stock up to an aggregate of \$8.0 million. As of December 31, 2013, we have spent a total of \$5.3 million buying back our common stock under this plan. There were no repurchases under this plan during the year ended December 31, 2013.

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

CONTRACTUAL OBLIGATIONS

The following table summarizes the known future payments required for the debt on our Consolidated Balance Sheet as of December 31, 2013. Where appropriate we have indicated the footnote in Part II, Item 8, Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements where additional information is available.

	Financial Note Reference	Payments Due By Period (in millions)						
		Total	2014	2015	2016	2017	2018	After 5 Years
Long-term debt obligations	13	\$155.7	\$13.2	\$16.5	\$20.2	\$105.1	\$0.2	\$0.5
Capital lease obligations, including interest	15	6.6	0.5	0.5	0.5	0.5	0.4	4.2
Convertible junior subordinated debenture ^(a)	14	89.8	—	—	—	—	—	89.8
Total contractual obligations		\$252.1	\$13.7	\$17.0	\$20.7	\$105.6	\$0.6	\$94.5

(a)Matures in 2029

Table of Contents**OFF-BALANCE SHEET ARRANGEMENTS**

The following table summarizes our off-balance sheet arrangements as of December 31, 2013. Where appropriate, we have indicated the footnote in Part II, Item 8, Financial Statements and Supplementary Data, Notes to the Consolidated Financial Statements where additional information is available. The interest payments on long-term debt are related to the long-term debt obligations in the table above. Other off-balance sheet arrangements relate to our operating leases and agreements with our employees, our executive officers and former owners.

	Financial Note Reference	Payments Due By Period (in millions)						
		Total	2014	2015	2016	2017	2018	After 5 Years
Operating leases	15	\$18.3	\$4.6	\$3.5	\$2.6	\$2.4	\$1.5	\$3.7
Interest payments on long-term debt		114.0	10.6	10.2	9.7	8.8	6.5	68.2
Non-compete agreements	15	5.6	1.5	1.3	1.1	0.6	0.4	0.7
Consulting agreements	15	3.0	1.3	0.8	0.5	0.2	0.1	0.1
Employment agreements	15	3.2	1.8	1.2	0.2	—	—	—
Total contractual cash obligations		\$144.1	\$19.8	\$17.0	\$14.1	\$12.0	\$8.5	\$72.7

The obligations related to our off-balance sheet arrangements are significant to our future liquidity; however, although we can provide no assurances, we anticipate that these obligations will be funded from cash provided from our operating activities. If we are not able to meet these obligations with cash provided by our operating activities, we may be required to access the capital markets or draw down on our revolving credit facility, both of which may be more difficult to access.

Uncertain tax positions recorded at December 31, 2013 total approximately \$7.8 million, excluding penalties and interest. The ultimate timing of when those obligations will be settled cannot be determined with reasonable assurance and have been excluded from the tables above. Refer to Note 16 to our consolidated financial statements.

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.

INFLATION

Inflation has not had a significant impact on our results of operations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

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

The following quantitative and qualitative information is provided about financial instruments to which we are a party to at December 31, 2013, and from which we may incur future gains or losses from changes in market conditions. We do not enter into derivative or other financial instruments for speculative or trading purposes.

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

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

In connection with our preneed funeral operations and preneed cemetery merchandise and service sales, the related funeral and cemetery trust funds own investments in equity and debt securities and mutual funds, which are sensitive to current market prices. Cost and market values of such investments as of December 31, 2013 are presented in Notes 6, 8 and 10 in Part II, Item 8, Financial Statements and Supplementary Data, Notes to the Consolidated Financial Statements. The sensitivity of the

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fixed income securities is such that a 0.25% change in interest rates causes an approximate 1.86% change in the value of the fixed income securities.

We monitor current and forecasted interest rate risk in the ordinary course of business and seek to maintain optimal financial flexibility, quality and solvency. As of December 31, 2013, we had \$36.9 million outstanding under our \$125 million revolving credit facility and \$117.0 million on our term loan. Any further borrowings or voluntary prepayments against the revolving credit facility or any change in the floating rate would cause a change in interest expense. We have the option to pay interest under our Credit Facility at either the prime rate or the LIBOR rate plus a margin. At December 31, 2013, the prime rate margin was equivalent to 1.50% and the LIBOR margin was 2.50%. Assuming the outstanding balance remains unchanged, a change of 100 basis points in our borrowing rate would result in a change in income before taxes of \$1.5 million. We have not entered into interest rate hedging arrangements in the past. Management continually evaluates the cost and potential benefits of interest rate hedging arrangements. The convertible junior subordinated debentures, payable to the Trust, pay interest at the fixed rate of 7% and are carried on our Consolidated Balance Sheets at a cost of approximately \$89.8 million, which approximates the fair value of these securities at December 31, 2013 based on Bloomberg Finance L.P.'s quotes for the corresponding preferred securities issued by the Trust.

Increases in market interest rates may cause the value of these debt instruments to decrease but such changes will not affect our interest costs. The remainder of the our long-term debt and leases consist of non-interest bearing notes and fixed rate instruments that do not trade in a market, nor otherwise have a quoted market value. Any increase in market interest rates causes the fair value of those liabilities to decrease.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.
CARRIAGE SERVICES, INC.
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Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders
Carriage Services, Inc.:

We have audited the accompanying consolidated balance sheets of Carriage Services, Inc. and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2013. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Carriage Services, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Carriage Services Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission(COSO), and our report dated March 5, 2014 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP
Houston, Texas
March 5, 2014

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

	December 31,	
	2012	2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,698	\$ 1,377
Accounts receivable, net of allowance for bad debts of \$1,177 in 2012 and \$847 in 2013	17,812	17,950
Assets held for sale	1,466	3,544
Inventories	5,133	5,300
Prepaid expenses	5,107	4,421
Other current assets	1,923	3,525
Total current assets	33,139	36,117
Preneed cemetery trust investments	70,960	68,341
Preneed funeral trust investments	82,896	97,144
Preneed receivables, net of allowance for bad debts of \$2,059 in 2012 and \$1,825 in 2013	23,222	24,521
Receivables from preneed trusts	25,871	11,166
Property, plant and equipment, net of accumulated depreciation of \$84,291 in 2012 and \$88,627 in 2013	152,433	160,690
Cemetery property	75,156	72,911
Goodwill	218,442	221,087
Deferred charges and other non-current assets	9,424	12,280
Cemetery perpetual care trust investments	46,542	42,342
Total assets	\$ 738,085	\$ 746,599
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	\$ 11,218	\$ 13,424
Accounts payable	5,243	7,046
Other liabilities	13,067	9,939
Accrued liabilities	12,278	12,854
Liabilities associated with assets held for sale	369	4,357
Total current liabilities	42,175	47,620
Long-term debt, net of current portion	118,841	105,642
Line of credit	44,700	36,900
Convertible junior subordinated debenture due in 2029 to an affiliate	89,770	89,770
Obligations under capital leases, net of current portion	4,013	3,786
Deferred preneed cemetery revenue	63,998	55,479
Deferred preneed funeral revenue	39,794	30,588
Deferred tax liability	—	11,915
Other long-term liabilities	—	1,548
Deferred preneed cemetery receipts held in trust	70,960	68,341
Deferred preneed funeral receipts held in trust	82,896	97,144
Care trusts' corpus	45,920	41,893
Total liabilities	603,067	590,626
Commitments and contingencies		
Redeemable Preferred Stock	200	—
Stockholders' equity:		

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Common stock, \$.01 par value; 80,000,000 shares authorized; 22,078,000 and 22,183,000 issued as of December 31, 2012 and 2013, respectively	221	222
Additional paid-in capital	202,462	204,324
Accumulated deficit	(52,598	) (33,306)
Treasury stock, at cost; 3,922,000 shares at December 31, 2012 and 2013	(15,267	) (15,267)
Total stockholders' equity	134,818	155,973
Total liabilities and stockholders' equity	\$738,085	\$746,599

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

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

	Year Ended December 31,		
	2011	2012	2013
Revenues:			
Funeral	\$141,112	\$152,004	\$163,965
Cemetery	42,402	47,388	49,992
	183,514	199,392	213,957
Field costs and expenses:			
Funeral	87,975	91,807	100,410
Cemetery	27,111	28,507	28,940
Depreciation and amortization	8,466	8,984	10,212
Regional and unallocated funeral and cemetery costs	9,025	9,952	10,014
	132,577	139,250	149,576
Gross profit	50,937	60,142	64,381
Corporate costs and expenses:			
General, administrative and other	21,732	22,494	25,922
Home office depreciation and amortization	1,013	964	1,456
	22,745	23,458	27,378
Operating income	28,192	36,684	37,003
Interest expense	(18,089)	) (17,088)	) (12,622)
Interest income and other, net	52	963	81
Gain on repurchase of junior subordinated debentures	846	—	—
Loss on early extinguishment of debt and other costs	(201)	) (3,031)) —
Total interest and other, net	(17,392)	) (19,156)	) (12,541)
Income from continuing operations before income taxes	10,800	17,528	24,462
Provision for income taxes	(4,590)	) (6,960)	) (9,277)
Net income from continuing operations	6,210	10,568	15,185
Income from discontinued operations, net of tax	768	835	4,111
Net income	6,978	11,403	19,296
Preferred stock dividend	14	14	4
Net income available to common stockholders	\$6,964	\$11,389	\$19,292
Basic earnings per common share:			
Continuing operations	\$0.34	\$0.58	\$0.83
Discontinued operations	0.04	0.05	0.23
Basic earnings per common share	\$0.38	\$0.63	\$1.06
Diluted earnings per common share:			
Continuing operations	\$0.34	\$0.58	\$0.82
Discontinued operations	0.04	0.05	0.18
Diluted earnings per common share	\$0.38	\$0.63	\$1.00
Dividends declared per share	\$0.075	\$0.10	\$0.10
Weighted average number of common and common equivalent shares outstanding:			
Basic	18,359	18,126	17,826

Diluted	18,397	18,226	22,393
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The accompanying notes are an integral part of these Consolidated Financial Statements.

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CARRIAGE SERVICES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(in thousands)

	Shares Outstanding	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Total
Balance – December 31, 2010	18,158	\$213	\$200,987	\$ (70,951)	\$(10,576)	\$119,673
Net Income – 2011	—	—	—	6,964	—	6,964
Issuance of common stock	125	1	521	—	—	522
Exercise of stock options	173	1	290	—	—	291
Issuance of restricted common stock	280	3	(3)	—	—	—
Cancellation and retirement of restricted common stock	(183)	(1)	(426)	—	—	(427)
Amortization of restricted common stock	—	—	1,530	—	—	1,530
Stock-based compensation expense	—	—	337	—	—	337
Treasury stock acquired	(126)	—	(576)	—	(160)	(736)
Dividends on common stock	—	—	(1,376)	—	—	(1,376)
Balance – December 31, 2011	18,427	217	201,284	(63,987)	(10,736)	126,778
Net Income – 2012	—	—	—	11,389	—	11,389
Issuance of common stock	151	1	843	—	—	844
Exercise of stock options	81	1	436	—	—	437
Issuance of restricted common stock	379	4	18	—	—	22
Cancellation and retirement of restricted common stock	(196)	(2)	(432)	—	—	(434)
Accelerated vesting of restricted common stock and options	—	—	281	—	—	281
Amortization of restricted common stock	—	—	1,370	—	—	1,370
Stock-based compensation expense	—	—	466	—	—	466
Treasury stock acquired	(686)	—	—	—	(4,531)	(4,531)
Dividends on common stock	—	—	(1,804)	—	—	(1,804)
Balance – December 31, 2012	18,156	221	202,462	(52,598)	(15,267)	134,818
Net Income – 2013	—	—	—	19,292	—	19,292
Issuance of common stock	114	1	1,393	—	—	1,394
Exercise of stock options	45	—	—	—	—	—
Issuance of restricted common stock	63	1	—	—	—	1
Cancellation and retirement of restricted common stock and options	(117)	(1)	(1,630)	—	—	(1,631)
Accelerated vesting of restricted common stock and options	—	—	667	—	—	667
Amortization of restricted common stock	—	—	1,340	—	—	1,340
Stock-based compensation expense	—	—	1,296	—	—	1,296
Dividends on common stock	—	—	(1,817)	—	—	(1,817)
Excess tax benefits on equity compensation	—	—	613	—	—	613
Balance – December 31, 2013	18,261	\$222	\$204,324	\$ (33,306)	\$(15,267)	\$155,973

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

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

	For the years ended December 31,		
	2011	2012	2013
Cash flows from operating activities:			
Net income	\$6,978	\$11,403	\$19,296
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	9,613	10,076	11,748
Impairment of goodwill	—	1,100	100
Gain on sale of business	—	(610	) (6,091
Amortization of deferred financing costs	653	685	362
Gain on repurchase of convertible junior subordinated debentures	(846) —	—
Provision for losses on accounts receivable	2,788	2,589	2,005
Stock-based compensation expense	1,867	2,174	3,583
Deferred income taxes (benefit)	(3,462	) 3,930	12,572
Loss on early extinguishment of debt	201	1,323	—
Other	38	88	85
Changes in operating assets and liabilities that provided (required) cash:			
Accounts and preneed receivables	(1,921	) (4,623	) (3,329
Inventories and other current assets	(1,513	) 5,332	(337
Deferred charges and other	(38	) (38	) (35
Preneed funeral and cemetery trust investments	10,956	6,659	(1,415
Accounts payable	5,188	(1,002	) 1,142
Accrued and other liabilities	1,818	(6,195	) (3,294
Deferred preneed funeral and cemetery revenue	10,316	3,720	1,187
Deferred preneed funeral and cemetery receipts held in trust	(11,481	) (10,850	) 2,266
Net cash provided by operating activities	31,155	25,761	39,845
Cash flows from investing activities:			
Acquisitions and new construction	(18,574	) (45,141	) (19,701
Net proceeds from sales of businesses and other assets	—	603	10,184
Capital expenditures	(10,644	) (10,436	) (10,695
Net cash used in investing activities	(29,218	) (54,974	) (20,212
Cash flows from financing activities:			
Net borrowings from (payments against) the revolving credit facility	2,500	43,307	(7,800
Payments on long-term debt and obligations under capital leases	(625	) (3,174	) (11,219
Proceeds from the exercise of stock options and employee stock purchase plan contributions	719	896	894
Dividends on common stock	(1,376	) (1,804	) (1,817
Dividends on redeemable preferred stock	(14	) (14	) (4
Payment of loan origination costs	(333	) (3,235	) (621
Excess tax benefit of equity compensation	25	36	613
Payment of call premium associated with the senior note redemption	—	(1,707) —
Purchase of treasury stock	(736) (4,531) —
Repurchase of convertible junior subordinated debentures	(2,241) —	—

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Other financing costs	2	—	—
Net cash provided by (used in) financing activities	(2,079) 29,774	(19,954)
Net increase (decrease) in cash and cash equivalents	(142	) 561	(321)
Cash and cash equivalents at beginning of year	1,279	1,137	1,698
Cash and cash equivalents at end of year	\$1,137	\$1,698	\$1,377

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

Carriage Services, Inc. (“Carriage,” the “Company,” “we,” “us,” or “our”) is a leading provider of deathcare services and merchandise in the United States. As of December 31, 2013, we operated 161 funeral homes in 26 states and 32 cemeteries in 10 states.

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

Principles of Consolidation

The accompanying Consolidated Financial Statements include the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated.

Funeral and Cemetery Operations

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

Accounts receivable included approximately \$8.4 million of funeral receivables at December 31, 2012 and 2013 and \$9.2 million and \$8.3 million of cemetery receivables at December 31, 2012 and 2013, respectively. For 2012 and 2013, accounts receivable also include minor amounts of other receivables. Non-current preneed receivables represent the payments expected to be received beyond one year from the balance sheet date. Non-current preneed receivables consisted of approximately \$7.3 million and \$8.1 million of funeral receivables and \$15.9 million and \$16.5 million of cemetery receivables at December 31, 2012 and 2013, respectively. Bad debt expense totaled approximately \$2.8 million, \$2.6 million and \$2.0 million for 2011, 2012 and 2013, respectively.

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 times 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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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

In accordance with respective state laws, we are required to deposit a specified amount into perpetual and memorial care trust funds for each interment/entombment right and certain memorials sold. Income from the trust funds is distributed to us and used to provide 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, 2013, CSV RIA provided these services to three institutions, which have custody of 78% of our trust assets, for a fee based on the market value of trust assets. Under state trust laws, we are allowed to charge the trust a fee for advising on the investment of the trust assets and these fees are recognized as income in the period in which services are provided.

Cash and Cash Equivalents

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

Inventory

Inventory consists primarily of caskets, outer burial containers and cemetery monuments and markers and is recorded at the lower of its cost basis (determined by the specific identification method) or net realizable value.

Property, Plant and Equipment

Property, plant and equipment (including equipment under capital leases) are stated at cost. The costs of ordinary maintenance and repairs are charged to operations as incurred, while renewals and betterments are capitalized.

Depreciation of property, plant and equipment (including equipment under capital leases) is computed based on the straight-line method over the following estimated useful lives of the assets:

	Years
Buildings and improvements	15 to 40
Furniture and fixtures	5 to 10
Machinery and equipment	3 to 15
Automobiles	5 to 7

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Property, plant and equipment was comprised of the following at December 31, 2012 and 2013:

	December 31, 2012	December 31, 2013
	(in thousands)	
Land	\$47,780	\$55,639
Buildings and improvements	127,864	132,172
Furniture, equipment and automobiles	61,080	61,506
Property, plant and equipment, at cost	236,724	249,317
Less: accumulated depreciation	(84,291	) (88,627)
Property, plant and equipment, net	\$152,433	\$160,690

During 2011, 2012 and 2013, we recorded approximately \$7.3 million, \$7.6 million and \$8.8 million, respectively, of depreciation expense against operating income.

Long-lived assets, such as property, plant and equipment subject to depreciation and amortization, are reviewed for impairment 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 earnings before interest, taxes, depreciation and amortization (“EBITDA”) for consecutive years or there has been a decline in EBITDA for consecutive years. For our cemetery business, we analyze the long-lived assets for impairment if the business has a negative operating margin or a decline in operating margin over a multiple year period. We review our long-lived assets if 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, 2013, no impairment was identified on long-lived assets.

Income Taxes

We and our subsidiaries file a consolidated U.S. Federal income tax return, separate state income tax returns in 16 states in which we operate and combined or unitary income tax returns in 11 states in which we operate. We record deferred taxes for temporary differences between the tax basis and financial reporting basis of assets and liabilities. We record a valuation allowance to reflect the estimated amount of deferred tax assets for which realization is uncertain. Management reviews the valuation allowance at the end of each quarter and makes adjustments if it is determined that it is more likely than not that the tax benefits will be realized.

We analyze tax benefits for uncertain tax positions and how they are to be recognized, measured and derecognized in our financial statements; provide certain disclosures of uncertain tax matters; and specify how reserves for uncertain tax positions should be classified on our Consolidated Balance Sheets. We have reviewed our income tax positions and identified certain tax deductions, primarily related to business acquisitions that are not certain. Our policy with respect to potential penalties and interest is to record them as “Other” expense and “Interest” expense, respectively. The entire balance of unrecognized tax benefits, if recognized, would affect our effective tax rate.

In July 2013, the Internal Revenue Service approved four tax accounting method changes, which allowed additional tax deductions totaling \$57.2 million in our 2012 tax year. These deductions related to temporary differences previously recorded as deferred tax assets. The non-current deferred tax liability of approximately \$11.9 million recorded as of December 31, 2013 is primarily a result of us obtaining the benefit of such tax accounting changes in 2013, while also utilizing net operating loss carryforwards arising from those changes against income from the current year.

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

In September 2013, the U.S. Department of the Treasury and the Internal Revenue Service released final regulations relating to guidance on applying tax rules to amounts paid to acquire, produce or improve tangible personal property as well as rules for materials and supplies. The new guidance is required to be applied no later than our tax year beginning January 1, 2014. We are evaluating the future impact of the final regulations on our tax provision.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Stock Plans and Stock-Based Compensation

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

See Note 17 to the Consolidated Financial Statements included herein for additional information on our stock-based compensation plans.

Computation of Earnings Per Common Share

Basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period. Dilutive common equivalent shares consist of stock options and convertible junior subordinated debentures.

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.

For the year ended December 31, 2013, the fully diluted weighted average shares outstanding and the corresponding calculation of fully diluted earnings per share include approximately 4.4 million shares that would be issued upon conversion of our convertible junior subordinated debentures as a result of the application of the if-converted method prescribed by ASC 260. For the years ended December 31, 2011 and 2012, the conversion of our convertible junior subordinated debentures is excluded from our fully diluted earnings per share calculations and the fully diluted weighted average share count because the inclusion of such converted shares would result in an antidilutive impact. See Note 20 to the Consolidated Financial Statements included herein for the computations of per share earnings for the fiscal years ended December 31, 2011, 2012 and 2013.

Fair Value Measurements

We define fair value as the price that would be received on the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We disclose the extent to which fair value is used to measure financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date. Additional required disclosures are provided in Notes 6, 10 and 11 to the Consolidated Financial Statements. 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, 2013, we did not incur significant decreases in the volume or level of activity of any asset or liability. We consider an impairment of debt and equity securities other-than-temporary unless (a) the investor has the ability and intent to hold an investment and (b) evidence indicating the cost of the investment is recoverable before we are more likely than not required to sell the investment. If an impairment is indicated, then an adjustment is made to reduce the carrying amount to fair value. As of December 31, 2013, no impairments have been identified.

In the ordinary course of business, we are typically exposed to a variety of market risks. Currently, these are primarily related to changes in fair market values related to outstanding debts and changes in the values of securities associated

with the preneed and perpetual care trusts. Management is actively involved in monitoring exposure to market risk and developing and utilizing appropriate risk management techniques when appropriate and when available for a reasonable price. Our convertible junior subordinated debentures, payable to Carriage Services Capital Trust (the "Trust"), pay interest at a fixed rate of 7% and are carried on our Consolidated Balance Sheets at a cost of approximately \$89.8 million which approximates the fair value at December 31, 2013 based on Bloomberg Finance L.P.'s quotes for the corresponding preferred securities issued by the Trust.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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 the fair value of assets and liabilities acquired. 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, assets, or liabilities associated with such acquisition. Acquisition related costs are recognized separately from acquisitions and are expensed as incurred.

During 2013, we completed one business acquisition consisting of two funeral homes, one in Tennessee and one in Georgia. See Note 3 to the Consolidated Financial Statements herein for further information on this acquisition.

Discontinued Operations

In accordance with our Strategic Acquisition Model, non-strategic businesses are reviewed to determine whether such businesses should be sold and the proceeds redeployed elsewhere. When we receive a letter of intent and financing commitment from a buyer and the sale is expected to occur within one year, the location is no longer reported within our continuing operations. The assets and liabilities associated with the location are reclassified as held for sale on our Consolidated Balance Sheets and the operating results are presented on a comparative basis in the discontinued operations section of our Consolidated Statements of Operations. There were no discontinued operations during 2011. During 2012, we ended a management contract with a cemetery in Ohio and sold two funeral homes in Kentucky. In 2013, we sold seven funeral homes, one in California, one in Ohio, one in Kentucky and four in Kansas and sold one cemetery in Virginia. At December 31, 2013, we had a letter of intent outstanding on a cemetery in Florida; as such, this business is no longer reported within our continuing operations and is presented on a comparative basis in the discontinued operations section of our Consolidated Statements of Operations, and the assets and liabilities associated with this location are classified as held for sale on our Consolidated Balance Sheets. See Note 5 to the Consolidated Financial Statements included herein for more information.

Goodwill

The excess of the purchase price over the fair value of identifiable net assets of funeral home businesses acquired is recorded as goodwill. Goodwill has primarily been recorded in connection with the acquisition of funeral businesses. Goodwill is tested for impairment by assessing the fair value of each of our reporting units. The funeral segment reporting units consist of 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, 2013.

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 2011 and 2012; however, for our 2013 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 testing, we compared the fair value of each reporting unit to its carrying value, including goodwill. We determined fair value for each reporting unit using both a market approach, weighted 70%, and an income approach, weighted 30%. Our methodology for determining a market approach fair value utilized recent sales transactions in the industry. 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, which may differ from actual future cash flows, using a weighted average cost of capital for the Company and other public deathcare companies. Goodwill impairment is not recorded where the fair value of the reporting unit exceeds its carrying amount. If the fair value of the reporting unit is less than its carrying amount, the implied fair value of goodwill is compared to the carrying amount of the reporting unit's goodwill and if the carrying amount exceeds the implied value, an impairment charge would be recorded in an amount equal to that excess.

In addition to our annual review, we assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may be greater than fair value. Factors that could trigger an interim impairment review

include, but are not limited to, significant adverse changes in the business climate which may be indicated by a decline in our market capitalization or decline in operating results. No impairments were recorded in relation to our goodwill annual assessment in 2012 or 2013. No such events or changes occurred between the testing date and year end to trigger a subsequent impairment review.

In 2012 and 2013, we recognized impairments of approximately \$1.1 million and \$0.1 million, respectively, for locations held for sale as of December 31, 2012 and 2013. 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Intangible Assets

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

In addition to our annual review, we assess the impairment of intangible assets whenever events or changes in circumstances indicate that the carrying value may be greater than the fair value. Factors that could trigger an interim impairment review include, but are not limited to, significant under performance relative to historical results and significant negative industry or economic trends.

Use of Estimates

The preparation of the Consolidated Financial Statements in conformity with U.S. generally accepted accounting principles 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 our estimates and judgments, including those related to revenue recognition, realization of accounts receivable, goodwill, intangible assets, property and equipment, accrued liabilities and deferred tax assets and liabilities. We base our estimates on historical experience, third party data and assumptions that we believe to be reasonable under the circumstances. The results of these considerations form the basis for making judgments about the amount and timing of revenues and expenses, the carrying value of assets and the recorded amounts of liabilities. Actual results may differ from these estimates and such estimates may change if the underlying conditions or assumptions change. Historical performance should not be viewed as indicative of future performance, as there can be no assurance that our results of operations will be consistent from year to year.

Subsequent Events

Management evaluated events and transactions during the period beginning subsequent to December 31, 2013 through the date the financial statements were issued for potential recognition or disclosure in the accompanying financial statements covered by this report. For more information regarding subsequent events, see Note 25 to the Consolidated Financial Statements herein.

2. RECENTLY ISSUED ACCOUNTING STANDARDS

Comprehensive Income

In February 2013, the Financial Accounting Standards Board (“FASB”) amended the Comprehensive Income Topic of the ASC to require reporting of amounts reclassified out of accumulated other comprehensive income (“AOCI”) by component. In addition, we are required to present significant amounts reclassified out of AOCI to net income in its entirety by the respective line items and to cross reference any disclosure elsewhere in the notes for amounts reclassified in less than their entirety. This amendment is effective prospectively for public companies for reporting periods after December 15, 2012. We adopted the provisions of this amendment effective January 1, 2013. See Note 17 to the Consolidated Financial Statements included herein for the appropriate disclosures.

Income Taxes

In July 2013, the FASB amended the Income Tax Topic of the ASC to eliminate the diversity in practice in the presentation of unrecognized tax benefits. Prior to the amendment, the ASC did not include explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The new guidance requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward unless specific circumstances exist, which would then result in the unrecognized tax benefit being reflected as a liability. This amendment is effective for the first annual or interim period beginning after December 15, 2013, thus effective for us beginning January 1, 2014. We will adopt the FASB’s amended guidance for our annual reporting period ending December 31, 2014. We do not anticipate the adoption of this amended guidance to have a significant impact on our financial position, results of operations or cash flows.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. ACQUISITIONS

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

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

We completed one acquisition in the fourth quarter of 2013 consisting of two funeral homes, one in Tennessee and one in Georgia. The consideration paid for this business was approximately \$13.7 million. During 2012, we completed seven acquisitions of funeral home businesses and one cemetery business for a total of \$42.7 million and the assumption of \$1.0 million of liabilities. The assets and liabilities for all acquisitions were recorded at fair value and included goodwill of \$25.7 million and \$3.8 million for 2012 and 2013, respectively. For all acquisitions, we acquired substantially all the assets and assumed certain operating liabilities including obligations associated with existing preneed contracts. The proforma impact of the acquisitions on the 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.

The following table summarizes the fair value of the assets acquired and liabilities assumed in our 2013 acquisition (in thousands):

Current assets	\$ 30
Property, plant & equipment	5,964
Goodwill	3,843
Deferred charges and other non-current assets	3,825
Accrued liabilities	(12)
Cash paid	\$ 13,650

Our purchase price allocation for this acquisition is dependent upon certain valuations, which have not progressed to a stage where there is sufficient information to make a definitive measure and allocation of goodwill and other intangible assets. Material revisions to the ongoing current estimates may be necessary when the valuation process is completed, within a year after closing date of the acquisition.

4. GOODWILL

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

We performed our 2013 annual impairment test of goodwill using information as of August 31, 2013. 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 2011 and 2012; however, for our 2013 annual impairment test, we performed the two-step goodwill impairment test. Our intent is to perform the two-step test least once every three years unless certain indicators or events suggest otherwise. Also see Note 1 to the Consolidated Financial Statements for a discussion of the methodology used for the annual goodwill impairment test. Based on our 2013 impairment test, we concluded that there was no impairment of goodwill.

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The following table presents changes in goodwill in the accompanying Consolidated Balance Sheets for the years ended December 31, 2012 and 2013 (in thousands):

	December 31, 2012	December 31, 2013
Goodwill at beginning of year	\$193,962	\$218,442
Increase in goodwill related to acquisitions	25,683	3,843
Impairments and changes in previous estimates	(1,118	) (101
Reclassification of assets held for sale	(85) —
Decrease in goodwill due to divestitures	—	(1,097
Goodwill at the end of the year	218,442	221,087

The impairment of \$0.1 million in the year ended December 31, 2013 is related to a business discontinued in the first quarter of 2013 as the carrying value exceeded fair value.

5. ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

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

During 2013, we sold seven funeral homes and one cemetery. During 2012, we ended a management agreement with a cemetery in Ohio and sold two funeral home businesses in Kentucky. We currently have a letter of intent outstanding on a cemetery in Florida; as such, this business is no longer reported within our continuing operations and the related operating results are presented on a comparative basis in the discontinued operations section of our Consolidated Statements of Operations. The assets and liabilities associated with this location are classified as held for sale in our Consolidated Balance Sheets.

See Note 25 to the Consolidated Financial Statements herein for further information concerning assets held for sale as of December 31, 2013.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Assets and liabilities associated with the cemetery and funeral home businesses held for sale in our Consolidated Balance Sheets at December 31, 2012 and 2013 consisted of the following (in thousands):

	December 31, 2012	December 31, 2013
Assets:		
Current assets	\$238	\$30
Preneed cemetery trust investments	—	2,477
Preneed receivables	—	31
Receivables from preneed trusts	—	—
Property, plant and equipment, net	797	311
Goodwill	85	—
Deferred charges and other non-current assets	346	—
Cemetery perpetual care trust investments	—	695
Total	\$1,466	\$3,544
Liabilities:		
Current liabilities	\$75	\$10
Deferred preneed cemetery revenue	—	1,185
Deferred preneed funeral revenue	294	—
Deferred preneed cemetery receipts held in trust	—	2,477
Care trusts corpus	—	685
Total	\$369	\$4,357

The operating results of the discontinued businesses during the periods presented, as well as the gain or impairment on disposal, are presented in the discontinued operations section of the Consolidated Statements of Operations, along with the income tax effect as follows (in thousands):

	Year Ended December 31,		
	2011	2012	2013
Revenues	\$7,099	\$6,526	\$3,280
Operating income	1,340	1,875	631
Impairment	—	(1,100)	(100)
Gain on disposition	—	610	6,091
Provision for income taxes	572	550	2,511
Income from discontinued operations	\$768	\$835	\$4,111

6. PRENEED TRUST INVESTMENTS**Preneed Cemetery Trust Investments**

Preneed cemetery trust investments represent trust fund assets that we are generally permitted to withdraw when the merchandise or services are provided. The components of Preneed cemetery trust investments in our Consolidated Balance Sheets at December 31, 2012 and 2013 are as follows (in thousands):

	December 31, 2012	December 31, 2013
Preneed cemetery trust investments, at market value	\$73,126	\$70,386
Less: allowance for contract cancellation	(2,166)	(2,045)
Preneed cemetery trust investments, net	\$70,960	\$68,341

Upon cancellation of a preneed cemetery contract, a customer is generally entitled to receive a refund of the corpus, and in some cases, some or all of the earnings held in trust. In certain jurisdictions, we are obligated to fund any

shortfall if the amounts deposited by the customer exceed the funds in trust, including some or all investment income.
As a result, when

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

realized or unrealized losses of a t