CARRIAGE SERVICES INC
Form 10-Q
November 03, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2015
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 1-11961
CARRIAGE SERVICES, INC.
(Exact name of registrant as specified in its charter)

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

3040 Post Oak Boulevard, Suite 300
Houston, Texas, 77056
(Address of principal executive offices)
(713) 332-8400
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Securities Exchange Act of 1934.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x
The number of shares of the registrant's Common Stock, $.01 par value per share, outstanding as of October 30, 2015 was 17,331,814.

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

	December 31, 2014	(unaudited) September 30, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$413	$396
Accounts receivable, net of allowance for bad debts of $1,127 in 2014 and $986 in 2015	19,264	18,093
Inventories	5,294	5,947
Prepaid expenses	4,590	3,709
Other current assets	7,144	2,517
Total current assets	36,705	30,662
Preneed cemetery trust investments	71,972	64,737
Preneed funeral trust investments	97,607	87,491
Preneed receivables, net of allowance for bad debts of $2,339 in 2014 and $1,967 in 2015	26,284	26,902
Receivables from preneed trusts, net of allowance for contract cancellations of $396 in 2014 and $416 in 2015	12,809	13,450
Property, plant and equipment, net of accumulated depreciation of $95,249 in 2014 and $100,857 in 2015	186,211	209,151
Cemetery property, net of accumulated amortization of $26,875 in 2014 and $29,355 in 2015	75,564	75,577
Goodwill	257,442	261,291
Deferred charges and other non-current assets	14,264	14,670
Cemetery perpetual care trust investments	48,670	44,146
Total assets	$827,528	$828,077
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	$9,838	$11,468
Accounts payable	6,472	10,222
Other liabilities	1,437	6,286
Accrued liabilities	15,203	15,397
Total current liabilities	32,950	43,373
Long-term debt, net of current portion	111,887	107,242
Revolving credit facility	40,500	63,000
Convertible subordinated notes due 2021	114,542	117,096
Obligations under capital leases, net of current portion	3,098	2,933
Deferred preneed cemetery revenue	56,875	56,786
Deferred preneed funeral revenue	31,265	31,786
Deferred tax liability	36,414	36,653
Other long-term liabilities	2,401	4,041
Deferred preneed cemetery receipts held in trust	71,972	64,737
Deferred preneed funeral receipts held in trust	97,607	87,491
Care trusts' corpus	48,142	43,846

Total liabilities	647,653	658,984
Commitments and contingencies:		
Stockholders' equity:		
Common stock, $.01 par value; 80,000,000 shares authorized and 22,434,609 and 22,458,450 shares issued at December 31, 2014 and September 30, 2015, respectively	224	225
Additional paid-in capital	212,386	213,506
Accumulated deficit	(17,468)	(2,049)
Treasury stock, at cost; 3,921,651 and 5,126,636 shares at December 31, 2014 and September 30, 2015, respectively	(15,267)	(42,589)
Total stockholders' equity	179,875	169,093
Total liabilities and stockholders' equity	$827,528	$828,077

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

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

	For the Three Months Ended September 30, 2014	For the Three Months Ended September 30, 2015	For the Nine Months Ended September 30, 2014	For the Nine Months Ended September 30, 2015
Revenues:				
Funeral	$41,770	$44,089	$127,926	$138,727
Cemetery	12,779	14,289	38,779	42,165
	54,549	58,378	166,705	180,892
Field costs and expenses:				
Funeral	25,930	26,798	77,906	82,476
Cemetery	7,988	8,292	23,002	24,040
Depreciation and amortization	2,654	3,019	7,744	8,814
Regional and unallocated funeral and cemetery costs	2,900	2,909	6,972	7,745
	39,472	41,018	115,624	123,075
Gross profit	15,077	17,360	51,081	57,817
Corporate costs and expenses:				
General and administrative costs and expenses	6,562	6,238	22,744	20,294
Home office depreciation and amortization	341	418	1,037	1,310
	6,903	6,656	23,781	21,604
Operating income	8,174	10,704	27,300	36,213
Interest expense	(2,177)	(2,577)	(7,707)	(7,725)
Accretion of discount on convertible subordinated notes	(782)	(876)	(1,647)	(2,554)
Loss on early extinguishment of debt	—	—	(1,042)	—
Loss on redemption of convertible junior subordinated debentures	—	—	(3,779)	—
Other income	—	—	1,130	—
Income from continuing operations before income taxes	5,215	7,251	14,255	25,934
Provision for income taxes	(2,390)	(2,807)	(5,915)	(10,515)
Income tax benefit related to uncertain tax positions	1,740	—	1,740	—
Net provision for income taxes	(650)	(2,807)	(4,175)	(10,515)
Net income from continuing operations	4,565	4,444	10,080	15,419
Income from discontinued operations, net of tax	431	—	381	—
Net income available to common stockholders	$4,996	$4,444	$10,461	$15,419
Basic earnings per common share:				
Continuing operations	$0.25	$0.24	$0.55	$0.84
Discontinued operations	0.02	—	0.02	—
Basic earnings per common share	$0.27	$0.24	$0.57	$0.84
Diluted earnings per common share:				
Continuing operations	$0.24	$0.24	$0.54	$0.82
Discontinued operations	0.02	—	0.02	—
Diluted earnings per common share	$0.26	$0.24	$0.56	$0.82
Dividends declared per common share	$0.025	$0.025	$0.075	$0.075

Weighted average number of common and common equivalent shares outstanding:				
Basic	18,150	17,874	18,086	18,115
Diluted	18,276	18,083	18,223	18,588

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

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

	For the Nine Months Ended September 30,	
	2014	2015
Cash flows from operating activities:		
Net income	$10,461	$15,419
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of businesses and purchase of other assets	(2,724)	(49)
Impairment of goodwill	1,180	—
Loss on early extinguishment of debt	1,042	—
Depreciation and amortization	8,801	10,124
Amortization of deferred financing costs	681	688
Accretion of discount on convertible subordinated notes	1,647	2,554
Provision for losses on accounts receivable	2,113	1,332
Stock-based compensation expense	3,702	3,448
Deferred income tax (benefit) expense	(140)	2,065
Loss on redemption of convertible junior subordinated debentures	2,932	—
Changes in operating assets and liabilities that provided (required) cash:		
Accounts and preneed receivables	(1,700)	(779)
Inventories and other current assets	725	3,277
Deferred charges and other	(196)	114
Preneed funeral and cemetery trust investments	(3,228)	21,234
Accounts payable	785	368
Accrued and other liabilities	(1,362)	4,408
Deferred preneed funeral and cemetery revenue	335	432
Deferred preneed funeral and cemetery receipts held in trust	2,595	(21,647)
Net cash provided by operating activities	27,649	42,988
Cash flows from investing activities:		
Acquisitions and land for new construction	(56,850)	(4,250)
Purchase of land and buildings previously leased	(7,600)	(6,080)
Net proceeds from the sale of businesses and other assets	1,927	65
Capital expenditures	(10,558)	(22,823)
Net cash used in investing activities	(73,081)	(33,088)
Cash flows from financing activities:		
Net borrowings on the revolving credit facility	5,400	22,500
Net borrowings (payments) on the term loan	5,656	(7,032)
Proceeds from the issuance of convertible subordinated notes	143,750	—
Payment of debt issuance costs related to the convertible subordinated notes	(4,650)	—
Payments on other long-term debt and obligations under capital leases	(662)	(679)
Redemption of convertible junior subordinated debentures	(89,748)	—
Payments for performance-based stock awards	(16,150)	—
Proceeds from the exercise of stock options and employee stock purchase plan contributions	1,035	575
Dividends on common stock	(1,379)	(1,385)
Payment of loan origination costs related to the credit facility	(825)	(13)

Purchase of treasury stock	—	(23,940)
Excess tax benefit of equity compensation	4,594	57
Net cash provided by (used in) financing activities	47,021	(9,917)
Net increase (decrease) in cash and cash equivalents	1,589	(17)
Cash and cash equivalents at beginning of period	1,377	413
Cash and cash equivalents at end of period	$2,966	$396

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

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

1.BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

Carriage Services, Inc. (“Carriage”, the “Company”, “we”, “us” or “our”) is a leading provider of deathcare services and merchandise in the United States. As of September 30, 2015, we operated 166 funeral homes in 27 states and 32 cemeteries in 11 states.

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

Principles of Consolidation and Interim Condensed Disclosures

Our unaudited condensed consolidated financial statements include the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated. Our interim condensed consolidated financial statements are unaudited but include all adjustments, which consist of normal, recurring accruals, that are necessary for a fair presentation of our financial position and results of operations as of and for the interim periods presented. Our unaudited condensed consolidated financial statements have been prepared in a manner consistent with the accounting principles described in our Annual Report on Form 10-K for the year ended December 31, 2014 unless otherwise disclosed herein, and should be read in conjunction therewith.

Reclassifications

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

Goodwill

The excess of the purchase price over the fair value of identifiable net assets of 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 perform our annual impairment test of goodwill using information as of August 31 of each year. In addition, we assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may be greater than fair value. Factors that could trigger an interim impairment review include, but are not limited to, significant adverse changes in the business climate which may be indicated by a decline in our market capitalization or decline in operating results.

Our methodology for goodwill impairment testing is described in more detail in Notes 1 and 4 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2014 and further discussion of current period activity in Note 3 to the Consolidated Financial Statements herein.

Funeral and Cemetery Operations

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

Allowances for bad debts and customer cancellations are provided at the date that the sale is recognized as revenue and are based on our historical experience and the current economic environment. We also monitor changes in delinquency rates and provide additional bad debt and cancellation reserves when warranted. When preneed sales of funeral services and merchandise are funded through third-party insurance policies, we earn a commission on the sale of the policies. Insurance commissions are recognized as revenues at the point at which the commission is no longer subject to refund, which is typically one year after the policy is issued.

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Accounts receivable included approximately $10.0 million and $7.7 million of funeral receivables at December 31, 2014 and September 30, 2015, respectively, and $9.1 million and $10.0 million of cemetery receivables at December 31, 2014 and September 30, 2015, respectively. For 2014 and 2015, accounts receivable also included minor amounts of other receivables. Non-current preneed receivables represented the payments expected to be received beyond one year from the balance sheet date. Non-current preneed receivables consisted of approximately $7.4 million of funeral receivables at December 31, 2014 and September 30, 2015 and $18.9 million and $19.5 million of cemetery receivables at December 31, 2014 and September 30, 2015, respectively. Bad debt expense totaled approximately $0.8 million and $0.5 million for the three months ended September 30, 2014 and 2015, respectively, and $2.1 million and $1.3 million for the nine months ended September 30, 2014 and 2015, respectively.

Property, Plant and Equipment

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

Property, plant and equipment was comprised of the following at December 31, 2014 and September 30, 2015:

	December 31, 2014	September 30, 2015
	(in thousands)	
Land	$66,957	$72,055
Buildings and improvements	148,483	167,933
Furniture, equipment and automobiles	66,020	70,020
Property, plant and equipment, at cost	281,460	310,008
Less: accumulated depreciation	(95,249)	(100,857)
Property, plant and equipment, net	$186,211	$209,151

We recorded depreciation expense of approximately $2.3 million and $2.6 million for the three months ended September 30, 2014 and 2015, respectively, and $6.8 million and $7.6 million for the nine months ended September 30, 2014 and 2015, respectively. During the third quarter of 2015, we opened a newly constructed funeral home in Katy, Texas.

Discontinued Operations

Effective January 1, 2015, we adopted the Financial Accounting Standards Board's (“FASB”) new guidance for reporting discontinued operations. In April 2014, the FASB amended the definition of “discontinued operations” to include only disposals or held-for-sale classifications for components or groups of components of an entity that represent a strategic shift that either has or will have a major effect on the entity's operations or financial results. Examples of a strategic shift that has or will have a major effect on an entity's operations and financial results include a disposal of a major geographical area, line of business, equity method of investment or other parts of an entity. The new guidance also requires the disclosure of pre-tax income of disposals that do not qualify as discontinued operations. We continually review locations to optimize the sustainable earning power and return on our invested capital. These reviews could entail selling certain non-strategic businesses. During the three and nine months ended September 30, 2015, there were no divestitures of our funeral home or cemetery businesses.

Subsequent Events

Management evaluated events and transactions during the period subsequent to September 30, 2015 through the date the financial statements were issued for potential recognition or disclosure in the accompanying financial statements covered by this report.

2.RECENTLY ISSUED ACCOUNTING STANDARDS

Simplifying the Accounting for Measurement-Period Adjustments for Business Combinations

In September 2015, the FASB issued Accounting Standards Update (“ASU”), Business Combinations - Simplifying the Accounting for Measurement-Period Adjustments (Topic 805). This ASU applies to all entities that have reported provisional amounts for items in a business combination for which the accounting is incomplete by the end of the reporting period in which the combination occurs and during the measurement period that have an adjustment to provisional amounts recognized. This ASU requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. These include the effect on earnings of changes in depreciation, amortization, or other income effects as if the accounting had been completed at the acquisition date. The entity is required to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in the current

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period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. This ASU is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. This ASU should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this ASU, with earlier application permitted for financial statements that have not been issued. Our adoption of this ASU for our fiscal year beginning January 1, 2016 is not expected to have a material effect on our financial statements.

Simplifying the Measurement of Inventory

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

Presentation of Debt Issuance Costs

In April 2015, the FASB issued ASU, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. To simplify the presentation of debt issuance costs, this ASU requires that entities that have historically presented debt issuance costs as an asset, related to a recognized debt liability, will be required to present those costs as a direct deduction from the carrying value of the related debt liability. This presentation will result in debt issuance costs being presented in the same way debt discounts have historically been handled. This ASU does not change the recognition, measurement or subsequent measurement guidance for debt issuance costs. This ASU is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption of this ASU is permitted for financial statements that have not been previously issued. The new guidance should be applied on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. Upon transition, an entity is required to comply with the applicable disclosures for a change in accounting principle. These disclosures include the nature and reason for the change in accounting principle, the transition method, a description of the prior-period information that has been retrospectively adjusted, and the effect of the change on debt issuance costs asset and the debt liability. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2016. Our adoption of this ASU is not expected to have a material effect on our financial statements.

Cloud Computing Arrangements

In April 2015, the FASB issued ASU, Intangibles–Goodwill and Other–Internal-Use Software (Subtopic 350-40), to provide guidance on whether a cloud computing arrangement contains a software license. If a cloud computing arrangement includes a software license, then an entity should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, an entity should account for the arrangement as a service contract. The new guidance is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. We plan to adopt these provisions for our fiscal year beginning January 1, 2016. Our adoption of this ASU is not expected to have a material effect on our financial statements.

Extraordinary and Unusual Items

In January 2015, the FASB issued ASU, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20). This ASU eliminates the concept of reporting extraordinary items. Extraordinary items are events and transactions that are distinguished by their unusual nature and by the infrequency of their occurrence. Preparers will not have to assess whether a particular event or transaction is extraordinary and likewise, auditors and regulators no longer need to evaluate whether a preparer treated an unusual and/or infrequent item appropriately. The presentation and disclosure guidance for items that are unusual in nature or occur infrequently will be retained and will be expanded to include such items. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after

December 15, 2015. A reporting entity may apply this ASU prospectively. A reporting entity may also apply this ASU retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. We plan to adopt these provisions for our fiscal year beginning January 1, 2016. Our adoption of this ASU is not expected to have a material effect on our financial statements.

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Going Concern

In August 2014, the FASB issued ASU, Presentation of Financial Statements - Going Concern (Subtopic 205-40). This ASU provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entities ability to continue as a going concern or to provide related footnote disclosures. This ASU requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently U.S. auditing standards. Specifically, this ASU provides a definition of the term substantial doubt, requires evaluation of every reporting period including interim periods, provides principles for considering the mitigating effect of management's plans, requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, requires an express statement and other disclosures when substantial doubt is not alleviated and requires an assessment for a period of one year after the date that the financial statements are issued or available to be issued. The ASU is effective for the annual period ending after December 15, 2016, and for annual and interim periods thereafter. Early application is permitted. We plan to adopt these provisions for our fiscal year beginning January 1, 2017.

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU, Revenue from Contracts with Customers. (Topic 606). ASC Topic 606 supersedes the revenue recognition requirements under ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the ASC. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. Under the new guidance, an entity is required to perform the following five steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The new guidance will significantly enhance comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. Additionally, the guidance requires improved disclosures as to the nature, amount, timing and uncertainty of revenue that is recognized. The guidance was effective for the annual reporting period beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. On July 9, 2015, the FASB deferred the effective date by one year to annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. We plan to adopt the provisions of this ASU for our fiscal year beginning January 1, 2018 and are currently evaluating the impact the adoption of this new accounting standard will have on our Consolidated Financial Statements.

3. GOODWILL

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

We performed our 2015 annual impairment test of goodwill using information as of August 31, 2015. 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. For our 2013 annual impairment test, we performed the two-step impairment test. For our 2014 and 2015 annual impairment tests, we performed qualitative reviews. Our intent is to perform the two-step test at least once every three years unless certain indicators or events suggest otherwise. See Part II, Item 7, Overview of Critical Accounting Policies and Estimates and Item 8. Financial Statements and Supplementary Data, Note 1, to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2014, for a discussion of the methodology used for the annual goodwill impairment test. For our 2015 annual impairment test, we performed a qualitative review and concluded that there was not an impairment to goodwill.

The following table presents the changes in goodwill on our Consolidated Balance Sheets during the nine months ended September 30, 2015 (in thousands):

Goodwill as of December 31, 2014	$257,442
Increase in goodwill related to acquisitions	3,849
Goodwill as of September 30, 2015	$261,291

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The $3.8 million increase in goodwill related to acquisitions represents the goodwill recorded in connection with the funeral home acquired in February 2015.

4. 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 on our Consolidated Balance Sheets at December 31, 2014 and September 30, 2015 were as follows (in thousands):

	December 31, 2014	September 30, 2015
Preneed cemetery trust investments, at fair value	$74,198	$67,000
Less: allowance for contract cancellation	(2,226)	(2,263)
Preneed cemetery trust investments, net	$71,972	$64,737

Upon cancellation of a preneed cemetery contract, a customer is generally entitled to receive a refund of the corpus, and in some cases, some or all of the earnings held in trust. In certain jurisdictions, we may be obligated to fund any shortfall if the amounts deposited by the customer exceed the funds in trust, including some or all investment income. As a result, when realized or unrealized losses of a trust result in the trust being under-funded, we assess whether we are responsible for replenishing the corpus of the trust, in which case a loss provision is recorded. At September 30, 2015, our preneed cemetery trust investments were not under-funded.

Earnings from our preneed cemetery trust investments are recognized in revenue when a service is performed or merchandise is delivered. Trust management fees charged by our wholly-owned registered investment advisor are included in revenue in the period in which they are earned.

Where quoted prices are available in an active market, investments held by the trusts are classified as Level 1 investments pursuant to the three-level valuation hierarchy. Our Level 1 investments include cash and common stock. Where quoted market prices are not available for the specific security, fair values are estimated by using quoted prices of similar securities in active markets or other inputs other than quoted prices that can corroborate observable market data. These investments are fixed income securities including municipal bonds, foreign debt, corporate debt, preferred stocks and mortgage backed securities, all of which are classified within Level 2 of the valuation hierarchy. We review and update our fair value hierarchy classifications quarterly. There were no transfers between Levels 1 and 2 in the three and nine months ended September 30, 2015. There are no Level 3 investments in the preneed cemetery trust investment portfolio. See Note 8 for further information of the fair value measurement and the three-level hierarchy.

The cost and fair market values associated with preneed cemetery trust investments at September 30, 2015 are detailed below (in thousands):

	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	1	$1,991	$—	$—	$1,991
Fixed income securities:					
Municipal bonds	2	457	—	(49)	408
Foreign debt	2	5,567	11	(488)	5,090
Corporate debt	2	25,636	122	(3,063)	22,695
Preferred stock	2	16,196	41	(666)	15,571
Common stock	1	25,602	316	(5,586)	20,332
Trust securities		$75,449	$490	$(9,852)	$66,087
Accrued investment income		$913			