Goldman SMALL CAP RESEARCH

The Goldman Guide

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INSIDE THIS ISSUE:

KEY TAKEAWAYS

- ⇒ *Conflicting signals galore in the global markets*
- ⇒ *Asia growth slowing and economic easing may help keep growth apace*
- ⇒ *U,S, stocks enjoyed better than expected Q3 results but morale is low*
- ⇒ *Time to think out of the box*
- ⇒ *Death care services microcap trading at big discount to its growth rate could be a takeover target down the road*

KEY STATISTICS

Index	Close	2014
DJIA	17810	7.4%
S&P 500	2064	11.7%
NASDAQ	4713	12.8%
Russell 2000	1172	0.7%

(figures are rounded)

The Only Certainty

With the short holiday week and with our Thanksgiving Special Report out tomorrow, I am sure you will notice that this week's Guide is shorter than usual.

You have also probably noticed that even as the major indices achieve new highs, there are a number of conflicting signals in front of us, thus making decisions regarding any new investments a difficult proposition.

Take Asia and Europe for example. Japan's weak economy has taken another step back and the China engine appears to be slowing, Much of Europe is also experiencing maddeningly slow growth. Yet, the addition of new liquidity into some of these markets have helped fuel the current euphoria which makes performance forecasting difficult.

In the U.S., despite relatively high valuations, enough stocks exceeded Q3 estimates to provide optimistic outlooks for the near term despite low morale nationwide, following divisive events on the political front.

Against these backdrops, it is important to remember that reasonably priced stocks that are primed to generate solid returns exist, regardless of season or circumstance. You just have to think outside of the box.

Carriage Services, Inc. (NYSE—CSV—$19.62) is as out of the box as they come and is the *poster child* for the old Ben Franklin adage: “There is nothing certain but death and taxes.” The death care services stock has performed very well, jumping by 400% in the past 4 years alone. With life expectancy increasing each year, one would think that business is at death's door. On the contrary-business is strong and CSV could ultimately be a takeover candidate in this acquisition–hungry industry.

Stock is Too Cheap

According to the Company's 3Q14 press release:

"Our third quarter performance was a record on most key performance metrics for what has historically been a seasonally low performance quarter. We achieved revenue growth of 10.2% to $54.5 million, Adjusted Consolidated EBITDA growth of 14.0% to $13.2 million, Adjusted Diluted Earnings Per Share growth of 93.8% to $0.31, and Adjusted Free Cash Flow growth of 69.9% to $11.6 million. The record earnings performance was primarily related to substantial contributions from our Funeral Acquisition and Financial Trust segments combined with large reductions of almost $1.0 million in regional and corporate fixed overhead and over $1.0 million in interest expense, primarily related to our recent convertible refinancing.

We believe that the earning power of Carriage will continue to trend higher in the fourth quarter and throughout 2015, which combined with a new, full pipeline of high quality acquisition candidates, supports raising our Rolling Four Quarter Outlook of Adjusted Diluted Earnings Per Share through September 30, 2015 to a range of $1.49 - $1.53."

Clearly, CSV is enjoying top-line growth in key segments, greater overall profitability and strong income growth from the financial trusts performance. EPS is expected to jump from $0.98 last year to $1.29 this year and then rise another 20% to $1.54 in 2015. At current levels, the stock is very inexpensive on a P/E basis, trades at a discount to its EPS growth rate and also when compared to typical P/E multiple of other stocks growing earnings by 20% annually. Based on Friday's close, CSV trades 20x 2013 EPS, 15x the 2014E EPS forecast, and the consensus 12.7x 2015E EPS projection. As earnings growth continues, we believe that this $365M market cap company could trade to the $26-28 level, which is still less than 20x 2015E EPS, and below the EPS growth rate.

While we do not expect a sale of the company during the completion of its own M&A initiatives, with the key senior management team now in their 70's, we could see a bigger player buy this highly profitable and growing services company. After all, with 164 funeral homes and 32 cemeteries, CSV is no small player.

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