

SERVICE CORPORATION INTERNATIONAL

Form 10-Q

August 08, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D. C. 20549  
FORM 10-Q**

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

**For the quarterly period ended June 30, 2007**

**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 1-6402-1**

**SERVICE CORPORATION INTERNATIONAL**

(Exact name of registrant as specified in its charter)

**Texas**

(State or other jurisdiction of  
incorporation or organization)

**74-1488375**

(I. R. S. employer  
identification number)

**1929 Allen Parkway, Houston, Texas**

(Address of principal executive offices)

**77019**

(Zip code)

**713-522-5141**

(Registrant's telephone number, including area code)

**None**

(Former name, former address, or former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act (check one).

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

YES  NO

The number of shares outstanding of the registrant's common stock as of August 1, 2007 was 287,099,141 (net of treasury shares).

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**GLOSSARY**

The following terms are common to the deathcare industry, are used throughout this report, and have the following meanings:

Atneed Funeral and cemetery arrangements after the death has occurred.

Burial Vaults A reinforced outer burial container intended to protect the casket against the weight of the earth.

Cash Overrides Funds received based on achieving certain dollar volume sales or production targets of life insurance policies.

Cremation The reduction of human remains to bone fragments by intense heat.

General Agency (GA) Revenues Commissions paid to the General Agency (GA) for life insurance policies or annuities sold to preneed customers for the purpose of funding preneed funeral arrangements. The commission rate paid is determined based on the product type sold, the length of payment terms, and the age of the insured/annuitant. The commission rate is applied to the face amount of the policy purchased to determine the commission amount payable to the GA. GA revenues are recognized as funeral revenues when the insurance purchase transaction between the customer and third party insurance provider is completed.

Interment The burial or final placement of human remains in the ground.

Lawn Crypt An outer burial receptacle constructed of concrete and reinforced steel, which is usually pre-installed in predetermined designated areas.

Marker A method of identifying the remains in a particular burial space, crypt, or niche. Permanent burial markers are usually made of bronze, granite, or stone.

Maturity At the time of death. This is the point at which preneed contracts are converted to atneed contracts.

Mausoleum An above ground structure that is designed to house caskets and cremation urns.

Perpetual Care or Endowment Care Fund A trust fund used for the maintenance and upkeep of burial spaces within a cemetery in perpetuity.

Preneed Funeral and cemetery arrangements made prior to the time of death.

Preneed Backlog Future revenues from unfulfilled preneed funeral and cemetery contractual arrangements.

Production Sales of preneed funeral and preneed or atneed cemetery contracts.

As used herein, SCI , Company , we , our , and us refer to Service Corporation International and companies owned directly or indirectly by Service Corporation International, unless the context requires otherwise.

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**SERVICE CORPORATION INTERNATIONAL**  
**CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS**  
**(UNAUDITED)**

**(In thousands, except per share amounts)**

|  | <b>Three months ended</b> |             | <b>Six months ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
| Revenues   | \$ 565,492                | \$ 431,400  | \$ 1,173,047            | \$ 873,401  |
| Costs and expenses   | (462,131)                 | (347,212)   | (928,532)               | (700,519)   |
| Gross profit   | 103,361                   | 84,188      | 244,515                 | 172,882     |
| General and administrative expenses  | (30,281)                  | (20,922)    | (65,680)                | (42,929)    |
| Gains (losses) on dispositions and impairment charges, net   | 9,743                     | (2,881)     | 2,063                   | (7,391)     |
| Operating income   | 82,823                    | 60,385      | 180,898                 | 122,562     |
| Interest expense   | (36,165)                  | (26,609)    | (73,762)                | (53,337)    |
| Loss on early extinguishment of debt   | (12,122)                  |             | (14,480)                |             |
| Interest income  | 2,478                     | 6,782       | 4,070                   | 12,763      |
| Equity in earnings of unconsolidated subsidiaries  | 5,559                     | 137         | 6,270                   | 137         |
| Other (expense) income, net  | (723)                     | 66          | (2,932)                 | 1,058       |
| Income from continuing operations before income taxes  | 41,850                    | 40,761      | 100,064                 | 83,183      |
| Provision for income taxes   | (28,941)                  | (15,404)    | (52,438)                | (31,049)    |
| Income from continuing operations  | 12,909                    | 25,357      | 47,626                  | 52,134      |
| Income from discontinued operations (net of income tax provision (benefit) of \$1,223, (\$13), \$1,960 and \$83, respectively) | 2,209                     | 93          | 5,134                   | 242         |
| Net income   | \$ 15,118                 | \$ 25,450   | \$ 52,760               | \$ 52,376   |
| Basic earnings per share:  |                           |             |                         |             |
| Income from continuing operations  | \$ .04                    | \$ .09      | \$ .16                  | \$ .18      |
| Income from discontinued operations, net of tax  | .01                       |             | .02                     |             |
| Net income   | \$ .05                    | \$ .09      | \$ .18                  | \$ .18      |
| Diluted earnings per share:  |                           |             |                         |             |
| Income from continuing operations  | \$ .04                    | \$ .09      | \$ .16                  | \$ .18      |
| Income from discontinued operations, net of tax  | .01                       |             | .02                     |             |
| Net income   | \$ .05                    | \$ .09      | \$ .18                  | \$ .18      |
| Basic weighted average number of shares  | 290,577                   | 293,409     | 291,941                 | 293,580     |

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|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Diluted weighted average number of shares | 296,124 | 297,501 | 297,480 | 297,784 |
| Dividends declared per share              | \$ .030 | \$ .025 | \$ .060 | \$ .050 |

(See notes to unaudited condensed consolidated financial statements)

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**SERVICE CORPORATION INTERNATIONAL**  
**CONDENSED CONSOLIDATED BALANCE SHEET**  
**(UNAUDITED)**  
**(In thousands, except share amounts)**

|   | <b>June 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|---|--------------------------|------------------------------|
| <b>Assets</b>   |                          |                              |
| Current assets:   |                          |                              |
| Cash and cash equivalents                               | \$ 222,785               | \$ 39,880                    |
| Receivables, net  | 102,107                  | 107,194                      |
| Inventories   | 39,017                   | 39,535                       |
| Current assets of discontinued operations               | 2,480                    | 2,236                        |
| Current assets held for sale                            | 3,033                    | 6,330                        |
| Other   | 37,363                   | 43,162                       |
| <b>Total current assets</b>                             | <b>406,785</b>           | <b>238,337</b>               |
| Preneed funeral receivables and trust investments       | 1,546,224                | 1,516,676                    |
| Preneed cemetery receivables and trust investments      | 1,550,552                | 1,522,584                    |
| Cemetery property, at cost                              | 1,465,152                | 1,495,248                    |
| Property and equipment, net                             | 1,605,899                | 1,641,353                    |
| Non-current assets of discontinued operations           | 380,579                  | 371,132                      |
| Non-current assets held for sale                        | 169,407                  | 349,311                      |
| Goodwill  | 1,260,587                | 1,264,272                    |
| Deferred charges and other assets                       | 396,861                  | 436,545                      |
| Cemetery perpetual care trust investments               | 958,947                  | 893,931                      |
|   | <b>\$ 9,740,993</b>      | <b>\$ 9,729,389</b>          |
| <b>Liabilities &amp; Stockholders Equity</b>            |                          |                              |
| Current liabilities:                                    |                          |                              |
| Accounts payable and accrued liabilities                | \$ 305,374               | \$ 341,173                   |
| Current maturities of long-term debt                    | 103,837                  | 46,176                       |
| Current liabilities of discontinued operations          | 3,071                    | 2,351                        |
| Current liabilities held for sale                       | 157                      | 419                          |
| Income taxes  | 22,498                   | 17,828                       |
| <b>Total current liabilities</b>                        | <b>434,937</b>           | <b>407,947</b>               |
| Long-term debt  | 1,837,318                | 1,912,696                    |
| Deferred preneed funeral revenues                       | 541,472                  | 537,792                      |
| Deferred preneed cemetery revenues                      | 735,098                  | 754,193                      |
| Deferred income taxes                                   | 99,866                   | 177,341                      |
| Non-current liabilities of discontinued operations      | 324,383                  | 311,498                      |
| Non-current liabilities held for sale                   | 116,161                  | 239,800                      |
| Other liabilities                                       | 479,506                  | 357,418                      |
| Non-controlling interest in funeral and cemetery trusts | 2,609,718                | 2,548,743                    |

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|   |              |              |
|---|--------------|--------------|
| Non-controlling interest in cemetery perpetual care trusts  | 955,358      | 887,186      |
| Commitments and contingencies (Note 16)   |              |              |
| Stockholders' equity:   |              |              |
| Common stock, \$1 per share par value, 500,000,000 shares authorized, 288,103,566 and 293,222,114, issued and outstanding (net of 7,975,808 and 10,000 treasury shares, at par) | 288,104      | 293,222      |
| Capital in excess of par value  | 2,063,246    | 2,135,649    |
| Accumulated deficit   | (858,068)    | (906,394)    |
| Accumulated other comprehensive income  | 113,894      | 72,298       |
| Total stockholders' equity  | 1,607,176    | 1,594,775    |
|   | \$ 9,740,993 | \$ 9,729,389 |

(See notes to unaudited condensed consolidated financial statements)

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**SERVICE CORPORATION INTERNATIONAL**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
**(UNAUDITED)**  
**(In thousands)**

|  | <b>Six months ended</b> |             |
|--|-------------------------|-------------|
|  | <b>June 30,</b>         |             |
|  | <b>2007</b>             | <b>2006</b> |
| <b>Cash flows from operating activities:</b>   |                         |             |
| Net income   | \$ 52,760               | \$ 52,376   |
| Adjustments to reconcile net income to net cash provided by operating activities:    |                         |             |
| Net income from discontinued operations, net of tax                                  | (5,134)                 | (242)       |
| Loss on early extinguishment of debt   | 14,480                  |             |
| Premiums paid on early extinguishment of debt  | (11,368)                |             |
| Depreciation and amortization  | 66,876                  | 45,670      |
| Amortization of cemetery property  | 17,800                  | 12,743      |
| Amortization of loan cost  | 3,617                   | 5,070       |
| Provision for doubtful accounts  | 6,688                   | 4,718       |
| Provision for deferred income taxes  | 38,024                  | 24,966      |
| (Gains) losses on dispositions and impairment charges, net                           | (2,063)                 | 7,391       |
| Share-based compensation   | 5,980                   | 3,856       |
| Excess tax benefits from share-based awards  | (4,123)                 |             |
| Equity in earnings of unconsolidated subsidiaries                                    | (6,270)                 | (137)       |
| Change in assets and liabilities, net of effects from acquisitions and dispositions: |                         |             |
| (Increase) decrease in receivables   | (5,222)                 | 18,001      |
| Increase in other assets   | (10,112)                | (16,431)    |
| Decrease in payables and other liabilities   | (40,626)                | (39,150)    |
| Effect of preneed funeral production and maturities:                                 |                         |             |
| Decrease in preneed funeral receivables and trust investments                        | 19,866                  | 14,505      |
| Increase in deferred preneed funeral revenue   | 20,303                  | 1,311       |
| Decrease in funeral non-controlling interest   | (25,518)                | (11,395)    |
| Effect of cemetery production and deliveries:  |                         |             |
| Decrease in preneed cemetery receivables and trust investments                       | 30,452                  | 11,895      |
| Increase (decrease) in deferred preneed cemetery revenue                             | 27,410                  | (12,979)    |
| (Decrease) increase in cemetery non-controlling interest                             | (19,215)                | 28,950      |
| Other  | (329)                   | (264)       |
| Net cash provided by operating activities from continuing operations                 | 174,276                 | 150,854     |
| Net cash provided by operating activities from discontinued operations               | 17,279                  | 749         |
| Net cash provided by operating activities  | 191,555                 | 151,603     |
| <b>Cash flows from investing activities:</b>   |                         |             |
| Capital expenditures   | (65,392)                | (40,533)    |
| Proceeds from divestitures and sales of property and equipment                       | 214,494                 | 26,744      |
| Acquisitions   | (212)                   | (14,677)    |
| Net withdrawals of restricted funds and other  | (238)                   | 10,613      |
| Net cash provided by (used in) investing activities from continuing operations       | 148,652                 | (17,853)    |
| Net cash (used in) provided by investing activities from discontinued operations     | (8,546)                 | 11,155      |

|  |            |            |
|--|------------|------------|
| Net cash provided by (used in) investing activities                | 140,106    | (6,698)    |
| <b>Cash flows from financing activities:</b>                       |            |            |
| Proceeds from long-term debt issued                                | 398,996    |            |
| Debt issuance costs  | (6,443)    |            |
| Payments of debt   | (2,152)    | (13,713)   |
| Principal payments on capital leases                               | (13,807)   | (10,701)   |
| Early extinguishment of debt                                       | (422,641)  |            |
| Proceeds from exercise of stock options                            | 13,189     | 2,402      |
| Purchase of Company common stock                                   | (103,598)  | (27,870)   |
| Excess tax benefits from share-based awards                        | 4,123      |            |
| Payments of dividends  | (17,645)   | (14,719)   |
| Bank overdrafts  | 2,211      |            |
| Net cash used in financing activities from continuing operations   | (147,767)  | (64,601)   |
| Net cash used in financing activities from discontinued operations | (2,113)    |            |
| Net cash used in financing activities                              | (149,880)  | (64,601)   |
| Effect of foreign currency   | 1,124      | 2,085      |
| Net increase in cash and cash equivalents                          | 182,905    | 82,389     |
| Cash and cash equivalents at beginning of period                   | 39,880     | 446,782    |
| Cash and cash equivalents at end of period                         | \$ 222,785 | \$ 529,171 |

(See notes to unaudited condensed consolidated financial statements)

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**SERVICE CORPORATION INTERNATIONAL**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**  
**(UNAUDITED)**  
**(In thousands)**

|   | <b>Outstanding<br/>shares</b> | <b>Common<br/>stock</b> | <b>Treasury<br/>stock,<br/>par<br/>value</b> | <b>Capital in<br/>excess of<br/>par value</b> | <b>Accumulated<br/>deficit</b> | <b>Accumulated<br/>other<br/>comprehensive<br/>income</b> | <b>Total</b> |
|---|-------------------------------|-------------------------|--|---|--------------------------------|---|--------------|
| Balance at<br>December 31,<br>2006                          | 293,222                       | \$ 293,232              | \$ (10)                                      | \$ 2,135,649                                  | \$ (906,394)                   | \$ 72,298   | \$ 1,594,775 |
| Cumulative effect<br>of adoption of FIN<br>48               |                               |                         |  |   | 11,987                         |   | 11,987       |
| Net income  |                               |                         |  |   | 52,760                         |   | 52,760       |
| Dividends declared<br>on common stock<br>(\$0.06 per share) |                               |                         |  | (17,603)                                      |                                |   | (17,603)     |
| Total other<br>comprehensive<br>income                      |                               |                         |  |   |                                | 41,596  | 41,596       |
| Employee share<br>based<br>compensation<br>earned           |                               |                         |  | 5,980   |                                |   | 5,980        |
| Stock option<br>exercises and other                         | 2,594                         | 2,534                   | 60   | 11,990  |                                |   | 14,584       |
| Restricted stock<br>awards, net of<br>forfeitures           | 314                           | 314                     |  | (314)   |                                |   |              |
| Tax benefit related<br>to share-based<br>awards             |                               |                         |  | 6,695   |                                |   | 6,695        |
| Purchase of<br>Company stock                                | (8,026)                       |                         | (8,026)                                      | (79,151)                                      | (16,421)                       |   | (103,598)    |
| Balance at June 30,<br>2007                                 | 288,104                       | \$ 296,080              | \$ (7,976)                                   | \$ 2,063,246                                  | \$ (858,068)                   | \$ 113,894  | \$ 1,607,176 |

(See notes to unaudited condensed consolidated financial statements)

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**SERVICE CORPORATION INTERNATIONAL**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in thousands, except per share amounts)**

**1. Nature of Operations**

We are a provider of deathcare products and services, with a network of funeral service locations and cemeteries primarily operating in the United States and Canada. We also own a minority interest in funeral operations of an entity in France for which we entered into an agreement to divest in the third quarter of 2007. Additionally, we own Kenyon International Emergency Services (Kenyon), a subsidiary that specializes in providing disaster management services in mass fatality incidents as well as training, planning, and crisis-communications consulting services. Kenyon's results are included in our funeral operations segment. As part of the Alderwoods transaction, we acquired Mayflower National Life Insurance Company, an insurance business for which, as of June 30, 2007, we had entered into a definitive agreement to sell, and which we sold in July 2007. The operations of this business are presented as discontinued operations in our condensed consolidated statement of operations and as assets and liabilities of discontinued operations on our condensed consolidated balance sheet.

Our funeral and cemetery operations consist of funeral service locations, cemeteries, funeral service/cemetery combination locations, crematoria, and related businesses. Funeral service locations provide all professional services relating to funerals and cremations, including the use of funeral facilities and motor vehicles and preparation and embalming services. Funeral related merchandise, including caskets, burial vaults, cremation receptacles, flowers, and other ancillary products and services, is sold at funeral service locations. Cemeteries provide cemetery property interment rights, including mausoleum spaces, lots, and lawn crypts, and sell cemetery related merchandise and services, including stone and bronze memorials, markers, casket and cremation memorialization products, merchandise installations, and burial openings and closings. We also sell preneed funeral and cemetery products and services whereby a customer contractually agrees to the terms of certain products and services to be provided in the future.

**2. Summary of Significant Accounting Policies**

*Principles of Consolidation and Basis of Presentation*

Our condensed consolidated financial statements include the accounts of Service Corporation International and all majority-owned subsidiaries. These statements also include the accounts of the funeral trusts, cemetery merchandise and services trusts, and perpetual care trusts in which we have a variable interest and are the primary beneficiary. The interim condensed consolidated financial statements are unaudited but include all adjustments, consisting of normal recurring accruals and any other adjustments, which management considers necessary for a fair presentation of the results for these periods. These condensed consolidated financial statements have been prepared in a manner consistent with the accounting policies described in our annual report on Form 10-K for the year ended December 31, 2006, unless otherwise disclosed herein, and should be read in conjunction therewith. The accompanying year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year period.

*Reclassifications*

We have reclassified certain prior period amounts to conform to the current period financial statement presentation with no effect on previously reported results of operations, financial condition, or cash flows.

*Use of Estimates in the Preparation of Financial Statements*

The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions as described in our Form 10-K that may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of expenses during the reporting period. As a result, actual results could differ from these estimates.

**Table of Contents****3. Recently Issued Accounting Standards***Split-Dollar Life Insurance Agreements*

In March 2007, the Financial Accounting Standards Board (FASB) ratified Emerging Issues Task Force Issue No. 06-10 *Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements* (EITF 06-10). EITF 06-10 provides guidance for determining a liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of a collateral assignment agreement. EITF 06-10 is effective for us beginning January 1, 2008. We are currently evaluating the impact of EITF 06-10 on our consolidated financial statements.

*Fair Value Option for Financial Assets and Liabilities*

In February 2007, the FASB issued Statement of Financial Accounting Standard (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). This Statement permits entities to choose to measure various financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for us beginning January 1, 2008. We are currently evaluating the impact of SFAS 159 on our consolidated financial statements.

*Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective beginning January 1, 2008 for us. We are currently evaluating the impact of SFAS 157 on our consolidated financial statements.

**4. Income Taxes***Accounting for Uncertainty in Income Taxes*

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertain income tax positions recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. This interpretation requires companies to use a prescribed model for assessing the financial statement recognition and measurement of all tax positions taken or expected to be taken in its tax returns. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

We adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, we recorded a \$12.0 million net increase in our liability for unrecognized tax benefits, which was recorded as a \$24.0 million increase to goodwill (related to uncertain tax positions acquired in the recent Alderwoods transaction) and a \$12.0 million reduction in our *accumulated deficit* as of January 1, 2007. As of the date of adoption and after considering the impact of recognizing the net liability increase noted above, our unrecognized tax benefits totaled \$257.1 million, of which \$156.3 million would impact our effective tax rate, if recognized.

In the second quarter of 2007, we recorded a \$1.3 million increase in the liability for unrecognized tax benefits due to a change in estimate, which was recorded as purchase price allocation adjustment. We also expect to recognize a net decrease in our liability for uncertain tax positions within the twelve months following January 1, 2007 of approximately \$6.0 million, relating to uncertain positions taken in prior years, as a result of expiring federal and state statutes.

We file numerous consolidated and separate income tax returns in the United States federal jurisdiction and in many state and foreign jurisdictions. A number of years may elapse before particular tax matters, for which we have unrecognized tax benefits, are audited and finally settled. In the United States, the Internal Revenue Service has recently completed its field work for tax years 1999 through 2002, and various state and foreign jurisdictions are auditing years through 2005. It is reasonably possible that one or more of these multi-jurisdictional audits will be settled in 2007 or later, as some are in the final approval stage, and if favorably resolved such settlements could result in a significant reduction in the amount of our unrecognized tax benefits.

Consistent with our historical financial reporting, we recognize potential accrued interest and penalties related to unrecognized tax benefits within our income tax expense account. We had recognized approximately \$51.3 million for the payment of interest and



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penalties at January 1, 2007, which is included in the \$257.1 million in unrecognized tax benefits noted above. During the three and six months ended June 30, 2007, we recognized an additional \$2.6 million and \$5.0 million in potential interest and penalties associated with uncertain tax positions. To the extent interest and penalties are not assessed with respect to uncertain tax positions in the future, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision.

*Effective Tax Rate*

The effective tax rates for the three and six months ended June 30, 2007 were 69.2% and 52.4%, respectively, compared to 37.8% and 37.3% for the same periods in 2006. The effective tax rates for 2007 were negatively impacted by permanent differences between the book and tax bases of asset dispositions, FIN 48 interest and penalties accrued on uncertain tax positions, and state income tax increases primarily as a result of changes in state tax laws.

**Table of Contents****5. Alderwoods Acquisition**

On November 28, 2006 we completed our acquisition of Alderwoods Group, Inc. (Alderwoods). In the first half of 2007, we adjusted our goodwill for various purchase price allocation adjustments as follows (in thousands):

|   |             |
|---|-------------|
| Adjustments to fair value of deferred revenue   | (25,186)    |
| Adjustments to fair value of intangible asset   | 22,453      |
| Adjustments to fair value of acquired locations | (49,322)    |
| Adjustments to deferred taxes                   | 36,247      |
| Adjustments to certain accrued liabilities      | 1,800       |
| Other   | 1,867       |
| <br>  |             |
| Total adjustment to Alderwoods goodwill         | \$ (12,141) |

During the second quarter, we recorded adjustments to the fair value of deferred revenue and intangible assets in connection with our recent reconciliations of the preneed funeral and cemetery backlog of Alderwoods. We also corrected the fair value of certain assets and liabilities sold during the quarter, including related deferred tax effects, for certain locations mandated for divestment pursuant to our FTC decree.

As of June 30, 2007, we had concluded our adjustments to the fair value of all assets acquired and liabilities assumed in the Alderwoods merger, with the exception of certain pre-acquisition contingencies. These pre-acquisition contingencies primarily relate to legal matters which existed at the date of the merger, but for which our final assessment required us to gather and analyze a significant amount of additional information and in so doing, to seek third party assistance. We expect to complete this assessment during the third quarter of 2007.

The condensed consolidated statement of operations for the three and six months ended June 30, 2007 includes the results of operations of Alderwoods. For the three and six months ended June 30, 2006, the following unaudited pro forma information presents information as if the merger occurred on January 1, 2006:

|  | <b>Three<br/>months<br/>ended<br/>June 30, 2006</b> | <b>Six months<br/>ended<br/>June 30, 2006</b> |
|--|---|---|
|  | <b>(In thousands)</b>                               |   |
| Revenues                                     | \$ 559,172  | \$ 1,139,871                                  |
| Income from continuing operations            | \$ 21,361   | \$ 47,354                                     |
| Net income                                   | \$ 21,454   | \$ 46,354                                     |
| Income from continuing operations per share: |   |   |
| Basic  | \$ 0.07   | \$ 0.16                                       |
| Diluted                                      | \$ 0.07   | \$ 0.16                                       |
| Net income per share:                        |   |   |
| Basic  | \$ 0.07   | \$ 0.16                                       |
| Diluted                                      | \$ 0.07   | \$ 0.16                                       |

**6. Preneed Funeral Activities**

*Preneed funeral receivables and trust investments*, net of allowance for cancellation, represent trust investments, including investment earnings and customer receivables related to unperformed, price-guaranteed preneed funeral contracts. When we, as the primary beneficiary, receive payments from the customer, we deposit the amount required by law into the trust and reclassify the corresponding amount from *Deferred preneed funeral revenues* into *Non-controlling interest in funeral and cemetery trusts*. Amounts are withdrawn from the trusts after the contract is performed. We deposited \$27.4 million and \$45.4 million into trusts during the three and six months ended June 30, 2007, respectively. We deposited \$22.8 million and \$41.9 million into trusts during the three and six months ended June 30, 2006, respectively. We withdrew \$39.2 million and \$74.2 million from trusts during the three and six months ended June 30, 2007, respectively. We withdrew \$26.0 million and \$56.5 million from trusts during the three and six

months ended June 30, 2006, respectively. Cash flows related to preneed funeral contracts are presented as operating cash flows in our condensed consolidated statement of cash flows.

The components of *Preneed funeral receivables and trust investments* in our condensed consolidated balance sheet at June 30, 2007 and December 31, 2006 are as follows:

|   | <b>June 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|---|--------------------------|------------------------------|
|   | <b>(In thousands)</b>    |                              |
| Trust investments, at market                      | \$ 1,353,765             | \$ 1,329,922                 |
| Receivables from customers                        | 223,620                  | 224,740                      |
|   | 1,577,385                | 1,554,662                    |
| Allowance for cancellation                        | (31,161)                 | (37,986)                     |
| Preneed funeral receivables and trust investments | \$ 1,546,224             | \$ 1,516,676                 |

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The cost and market values associated with funeral trust investments at June 30, 2007 and December 31, 2006 are detailed below. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds, and private equity investments. Fair market value represents the value of the underlying securities or cash held by the common trust funds, mutual funds at published values and the estimated market value of private equity investments (including debt as well as the estimated fair value related to the contract holders' equity in majority-owned real estate investments). The fair market value of funeral trust investments, which in the aggregate represented 104% and 103% of the related cost basis of such investments as of June 30, 2007 and December 31, 2006, respectively, was based primarily on quoted market prices at the balance sheet date. We assess our trust investments for other-than-temporary declines in fair value on a quarterly basis. As a result of our most recent review at June 30, 2007, we recorded a \$3.6 million impairment charge as a result of other-than-temporary declines in fair value related to unrealized losses on certain private equity and other investments. The impairment charges are recognized as investment losses and offset by interest income related to non-controlling interest in funeral trust investments in *Other (expense) income, net* in our condensed consolidated statement of operations. See Note 9 to the condensed consolidated financial statements for further information related to non-controlling interest in funeral trust investments. We believe the remaining unrealized losses of \$15.2 million related to trust investments are temporary in nature.

|   | <b>June 30, 2007</b>  |                             |                              | <b>Fair<br/>Market<br/>Value</b> |
|---|-----------------------|-----------------------------|------------------------------|----------------------------------|
|   | <b>Cost</b>           | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> |                                  |
|   | <b>(In thousands)</b> |                             |                              |                                  |
| Cash and cash equivalents                             | \$ 174,227            | \$                          | \$                           | \$ 174,227                       |
| Fixed income securities:                              |                       |                             |                              |                                  |
| U.S. Treasury   | 65,260                | 1,851                       | (281)                        | 66,830                           |
| Foreign government                                    | 91,972                | 194                         | (1,058)                      | 91,108                           |
| Corporate   | 8,772                 | 444                         | (80)                         | 9,136                            |
| Mortgage-backed                                       | 3,326                 | 114                         | (29)                         | 3,411                            |
| Insurance-backed                                      | 212,675               |                             |                              | 212,675                          |
| Equity securities:                                    |                       |                             |                              |                                  |
| Preferred stock                                       | 2,359                 | 167                         | (15)                         | 2,511                            |
| Common stock  | 357,953               | 29,710                      | (2,424)                      | 385,239                          |
| Mutual funds:   |                       |                             |                              |                                  |
| Equity  | 132,201               | 21,301                      | (536)                        | 152,966                          |
| Fixed income  | 208,563               | 10,547                      | (2,399)                      | 216,711                          |
| Private equity and other                              | 59,965                | 3,816                       | (8,426)                      | 55,355                           |
| Trust investments                                     | \$ 1,317,273          | \$ 68,144                   | \$ (15,248)                  | \$ 1,370,169                     |
| Less: Assets associated with businesses held for sale |                       |                             |                              | (16,404)                         |
|   |                       |                             |                              | \$ 1,353,765                     |

|  | <b>December 31, 2006</b> |                             |                              | <b>Fair<br/>Market<br/>Value</b> |
|--|--------------------------|-----------------------------|------------------------------|----------------------------------|
|  | <b>Cost</b>              | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> |                                  |

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|   | <b>(In thousands)</b> |           |            |              |
|---|-----------------------|-----------|------------|--------------|
| Cash and cash equivalents                             | \$ 235,178            | \$        | \$         | \$ 235,178   |
| Fixed income securities:                              |                       |           |            |              |
| U.S. Treasury   | 72,280                | 1,648     | (278)      | 73,650       |
| Foreign government                                    | 86,770                | 608       | (471)      | 86,907       |
| Corporate   | 4,844                 | 132       | (44)       | 4,932        |
| Mortgage-backed                                       | 4,390                 | 116       | (43)       | 4,463        |
| Insurance-backed                                      | 203,709               |           |            | 203,709      |
| Equity securities:                                    |                       |           |            |              |
| Preferred stock                                       | 714                   | 47        | (5)        | 756          |
| Common stock  | 328,672               | 22,425    | (2,698)    | 348,399      |
| Mutual funds:   |                       |           |            |              |
| Equity  | 124,154               | 12,896    | (539)      | 136,511      |
| Fixed income  | 212,302               | 8,561     | (2,254)    | 218,609      |
| Private equity and other                              | 65,127                | 1,328     | (783)      | 65,672       |
| Trust investments                                     | \$ 1,338,140          | \$ 47,761 | \$ (7,115) | \$ 1,378,786 |
| Less: Assets associated with businesses held for sale |                       |           |            | (48,864)     |
|   |                       |           |            | \$ 1,329,922 |

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Maturity dates of the fixed income securities range from 2007 to 2038. Maturities of fixed income securities at June 30, 2007 are estimated as follows:

|                          | <b>Market<br/>(In<br/>thousands)</b> |
|--------------------------|--------------------------------------|
| Due in one year or less  | \$ 97,204                            |
| Due in one to five years | 75,608                               |
| Due in five to ten years | 108,136                              |
| Thereafter               | 102,212                              |
|                          | <b>\$ 383,160</b>                    |

During the three months ended June 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$84.5 million and \$127.5 million, respectively. These sale transactions resulted in \$23.3 million and \$5.7 million of realized gains and realized losses, respectively, for the three months ended June 30, 2007. During the three months ended June 30, 2006, purchases and sales of available-for-sale securities included in trust investments were \$57.6 million and \$63.9 million, respectively. These sale transactions resulted in \$15.4 million and \$6.4 million of realized gains and realized losses, respectively for the three months ended June 30, 2006.

During the six months ended June 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$311.9 million and \$195.5 million, respectively. These sale transactions resulted in \$32.8 million and \$12.1 million of realized gains and realized losses, respectively, for the six months ended June 30, 2007. During the six months ended June 30, 2006, purchases and sales of available-for-sale securities included in trust investments were \$154.7 million and \$159.7 million, respectively. These sale transactions resulted in \$33.8 million and \$11.8 million of realized gains and realized losses, respectively for the six months ended June 30, 2006.

Earnings from all trust investments are recognized in current funeral revenues when the service is performed, merchandise is delivered, or upon cancellation of the amount we are entitled to retain. Recognized earnings (realized and unrealized) related to these trust investments were \$10.8 million and \$9.0 million for the three months ended June 30, 2007 and 2006, respectively. Recognized earnings (realized and unrealized) related to these trust investments were \$22.1 million and \$19.0 million for the six months ended June 30, 2007 and 2006, respectively.

**7. Preneed Cemetery Activities**

*Preneed cemetery receivables and trust investments*, net of allowance for cancellation, represent trust investments, including investment earnings, and customer receivables, net of unearned finance charges, for contracts sold in advance of when the property interment rights, merchandise, or services are needed. When we, as the primary beneficiary, receive payments from the customer, we deposit the amount required by law into the trust, remove the corresponding amount from *Deferred preneed cemetery revenues*, and record the amount into *Non-controlling interest in funeral and cemetery trusts*. Amounts are withdrawn from the trusts when the contract is performed. We deposited \$30.6 million and \$32.1 million into and withdrew \$44.2 million and \$20.1 million from the trusts during the three months ended June 30, 2007 and 2006, respectively. We deposited \$59.2 million and \$64.3 million into and withdrew \$81.2 million and \$41.2 million from the trusts during the six months ended June 30, 2007 and 2006, respectively. Cash flows related to preneed cemetery contracts are presented as operating cash flows in our condensed consolidated statement of cash flows.

The components of *Preneed cemetery receivables and trust investments* in the condensed consolidated balance sheet at June 30, 2007 and December 31, 2006 are as follows:

|                              | <b>June 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|------------------------------|--------------------------|------------------------------|
|                              | <b>(In thousands)</b>    |                              |
| Trust investments, at market | \$ 1,275,097             | \$ 1,236,446                 |

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|  |              |              |
|--|--------------|--------------|
| Receivables from customers                         | 372,183      | 384,428      |
| Unearned finance charges                           | (52,764)     | (54,704)     |
|  | 1,594,516    | 1,566,170    |
| Allowance for cancellation                         | (43,964)     | (43,586)     |
| Preneed cemetery receivables and trust investments | \$ 1,550,552 | \$ 1,522,584 |

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The cost and market values associated with the cemetery merchandise and service trust investments at June 30, 2007 and December 31, 2006 are detailed below. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds, and private equity investments. Fair market value represents the value of the underlying securities or cash held by the common trust funds, mutual funds at published values, and the estimated market value of private equity investments (including debt as well as the estimated fair value related to the contract holders' equity in majority-owned real estate alternative investments). The fair market value of cemetery trust investments, which in the aggregate represented 107% and 106% of the related cost basis of such investments as of June 30, 2007 and December 31, 2006, was based primarily on quoted market prices at the balance sheet date. We assess our trust investments for other-than-temporary declines in fair value on a quarterly basis. As a result of our most recent review at June 30, 2007, we recorded a \$3.2 million impairment charge as a result of other than temporary declines in fair value related to unrealized losses on certain private equity and other investments. The impairment charges are recognized as investment losses and offset by interest income related to non-controlling interest in cemetery trust investments in *Other (expense) income, net* in our condensed consolidated statements of operations. See Note 9 to the condensed consolidated financial statements for further information related to non-controlling interest in cemetery trust investments. We believe the remaining unrealized losses of \$16.0 million related to trust investments are temporary in nature.

|   | <b>June 30, 2007</b> |                             |                              | <b>Fair<br/>Market<br/>Value</b> |
|---|----------------------|-----------------------------|------------------------------|----------------------------------|
|   | <b>Cost</b>          | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> |                                  |
|   |                      | <b>(In thousands)</b>       |                              |                                  |
| Cash and cash equivalents                             | \$ 146,584           | \$                          | \$                           | \$ 146,584                       |
| Fixed income securities:                              |                      |                             |                              |                                  |
| U.S. Treasury   | 70,922               | 5,352                       | (2,333)                      | 73,941                           |
| Foreign government                                    | 29,174               | 394                         | (178)                        | 29,390                           |
| Corporate   | 11,281               | 899                         | (90)                         | 12,090                           |
| Equity securities:                                    |                      |                             |                              |                                  |
| Preferred stock                                       | 4,059                | 325                         | (32)                         | 4,352                            |
| Common stock  | 357,197              | 33,519                      | (2,790)                      | 387,926                          |
| Mutual funds:   |                      |                             |                              |                                  |
| Equity  | 219,022              | 39,280                      | (1,210)                      | 257,092                          |
| Fixed income  | 386,425              | 23,128                      | (4,266)                      | 405,287                          |
| Private equity and other                              | 29,878               | 1,728                       | (5,090)                      | 26,516                           |
| Trust investments                                     | \$ 1,254,542         | \$ 104,625                  | \$ (15,989)                  | \$ 1,343,178                     |
| Less: Assets associated with businesses held for sale |                      |                             |                              | (68,081)                         |
|   |                      |                             |                              | \$ 1,275,097                     |

|                           | <b>December 31, 2006</b> |                             |                              | <b>Fair<br/>Market<br/>Value</b> |
|---------------------------|--------------------------|-----------------------------|------------------------------|----------------------------------|
|                           | <b>Cost</b>              | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> |                                  |
|                           |                          | <b>(In thousands)</b>       |                              |                                  |
| Cash and cash equivalents | \$ 258,365               | \$                          | \$                           | \$ 258,365                       |

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|   |              |           |             |              |
|---|--------------|-----------|-------------|--------------|
| Fixed income securities:                              |              |           |             |              |
| U.S. Treasury   | 61,785       | 4,195     | (2,147)     | 63,833       |
| Foreign government                                    | 25,187       | 745       | (30)        | 25,902       |
| Corporate   | 5,223        | 398       | (32)        | 5,589        |
| Equity securities:                                    |              |           |             |              |
| Preferred stock                                       | 2,054        | 158       | (12)        | 2,200        |
| Common stock  | 300,188      | 26,726    | (1,756)     | 325,158      |
| Mutual funds:   |              |           |             |              |
| Equity  | 208,396      | 28,309    | (729)       | 235,976      |
| Fixed income  | 374,636      | 21,204    | (3,039)     | 392,801      |
| Private equity and other                              | 28,802       | 499       | (4,153)     | 25,148       |
| Trust investments                                     | \$ 1,264,636 | \$ 82,234 | \$ (11,898) | \$ 1,334,972 |
| Less: Assets associated with businesses held for sale |              |           |             | (98,526)     |
|   |              |           |             | \$ 1,236,446 |

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Maturity dates of the fixed income securities range from 2007 to 2038. Maturities of fixed income securities at June 30, 2007 are estimated as follows:

|                          | <b>Market<br/>(In<br/>thousands)</b> |
|--------------------------|--------------------------------------|
| Due in one year or less  | \$ 13,542                            |
| Due in one to five years | 30,777                               |
| Due in five to ten years | 47,506                               |
| Thereafter               | 23,596                               |
|                          | <b>\$ 115,421</b>                    |

During the three months ended June 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$112.7 million and \$94.8 million, respectively. These sale transactions resulted in \$23.0 million and \$5.5 million of realized gains and realized losses, respectively, for the three months ended June 30, 2007. During the three months ended June 30, 2006, purchases and sales of available-for-sale securities included in trust investments were \$80.7 million and \$102.1 million, respectively. These sale transactions resulted in \$17.7 million and \$7.3 million of realized gains and realized losses, respectively for the three months ended June 30, 2006.

During the six months ended June 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$357.0 million and \$203.6 million, respectively. These sale transactions resulted in \$36.3 million and \$12.4 million of realized gains and realized losses, respectively, for the six months ended June 30, 2007. During the six months ended June 30, 2006, purchases and sales of available-for-sale securities included in trust investments were \$187.4 million and \$197.4 million, respectively. These sale transactions resulted in \$34.5 million and \$13.8 million of realized gains and realized losses, respectively for the six months ended June 30, 2006.

Earnings from all trust investments are recognized in current cemetery revenues when the service is performed or the merchandise is delivered, or upon cancellation of the amount we are entitled to retain. Recognized earnings (realized and unrealized) related to these trust investments were \$5.2 million and \$3.3 million for the three months ended June 30, 2007 and 2006, respectively. Recognized earnings (realized and unrealized) related to these trust investments were \$9.8 million and \$6.7 million for the six months ended June 30, 2007 and 2006, respectively.

**8. Cemetery Perpetual Care Trusts**

We are required by state or provincial law to pay into perpetual care trusts a portion of the proceeds from the sale of cemetery property interment rights. As the primary beneficiary of the trusts, we consolidate the perpetual care trust investments with a corresponding amount recorded as *Non-controlling interest in perpetual care trusts*. We deposited \$10.5 million and \$5.9 million into trusts and withdrew \$10.3 million and \$21.4 million from trusts during the three months ended June 30, 2007 and 2006, respectively. We deposited \$14.6 million and \$11.2 million into trusts and withdrew \$18.7 million and \$29.3 million from trusts during the six months ended June 30, 2007 and 2006, respectively. Cash flows related to cemetery perpetual care contracts are presented as operating cash flows in our condensed consolidated statement of cash flows.

The cost and market values associated with trust investments held in perpetual care trusts at June 30, 2007 and December 31, 2006 are detailed below. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds, and private equity investments. Fair market value represents the value of the underlying securities or cash held by the common trust funds, mutual funds at published values, and the estimated market value of private equity investments (including debt as well as the estimated fair value related to the contract holders' equity in majority-owned real estate investments). The fair market value of perpetual care trusts, which in the aggregate represented 102% and 105% of the related cost basis of such investments as of June 30, 2007 and December 31, 2006, respectively, was based primarily on quoted market prices at the balance sheet date. We assess our trust investments for other-than-temporary declines in fair value on a quarterly basis. As a result of our most recent review at June 30, 2007, we recorded a \$1.2 million impairment charge as a result of other than temporary

declines in fair value related to unrealized losses on certain private equity and other investments. The impairment charges are recognized as investment losses and offset by interest income related to non-controlling interest in perpetual care trust investments in *Other (expense) income, net* in our condensed consolidated statements of operations. See Note 9 to the condensed consolidated financial statements for further information related to non-controlling interest in perpetual care trust investments. We believe the remaining unrealized losses of \$9.0 million related to trust investments are temporary in nature.

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|   | <b>June 30, 2007</b>  |                             |                              | <b>Fair<br/>Market<br/>Value</b> |
|---|-----------------------|-----------------------------|------------------------------|----------------------------------|
|   | <b>Cost</b>           | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> |                                  |
|   | <b>(In thousands)</b> |                             |                              |                                  |
| Cash and cash equivalents                             | \$ 78,335             | \$                          | \$                           | \$ 78,335                        |
| Fixed income securities:                              |                       |                             |                              |                                  |
| U.S. Treasury   | 3,257                 | 568                         | (86)                         | 3,739                            |
| Foreign government                                    | 33,325                | 593                         | (312)                        | 33,606                           |
| Corporate   | 30,056                | 604                         | (123)                        | 30,537                           |
| Mortgage-backed                                       | 695                   | 1                           | (8)                          | 688                              |
| Equity securities:                                    |                       |                             |                              |                                  |
| Preferred stock                                       | 5,407                 | 172                         | (16)                         | 5,563                            |
| Common stock  | 100,205               | 6,437                       | (361)                        | 106,281                          |
| Mutual funds:   |                       |                             |                              |                                  |
| Equity  | 75,592                | 5,884                       | (1,114)                      | 80,362                           |
| Fixed income  | 590,774               | 11,897                      | (5,272)                      | 597,399                          |
| Private equity and other                              | 39,831                | 2,078                       | (1,738)                      | 40,171                           |
| Perpetual care trust investments                      | \$ 957,477            | \$ 28,234                   | \$ (9,030)                   | \$ 976,681                       |
| Less: Assets associated with businesses held for sale |                       |                             |                              | (17,734)                         |
|   |                       |                             |                              | \$ 958,947                       |

|                                  | <b>December 31, 2006</b> |                             |                              | <b>Fair<br/>Market<br/>Value</b> |
|----------------------------------|--------------------------|-----------------------------|------------------------------|----------------------------------|
|                                  | <b>Cost</b>              | <b>Unrealized<br/>Gains</b> | <b>Unrealized<br/>Losses</b> |                                  |
|                                  | <b>(In thousands)</b>    |                             |                              |                                  |
| Cash and cash equivalents        | \$ 167,464               | \$                          | \$                           | \$ 167,464                       |
| Fixed income securities:         |                          |                             |                              |                                  |
| U.S. Treasury                    | 11,557                   | 655                         | (117)                        | 12,095                           |
| Foreign government               | 28,738                   | 952                         | (101)                        | 29,589                           |
| Corporate                        | 24,067                   | 1,255                       | (13)                         | 25,309                           |
| Mortgage-backed                  | 639                      | 2                           | (8)                          | 633                              |
| Equity securities:               |                          |                             |                              |                                  |
| Preferred stock                  | 7,931                    | 557                         | (1)                          | 8,487                            |
| Common stock                     | 86,945                   | 8,806                       | (115)                        | 95,636                           |
| Mutual funds:                    |                          |                             |                              |                                  |
| Equity                           | 61,498                   | 5,077                       | (212)                        | 66,363                           |
| Fixed income                     | 481,267                  | 24,048                      | (1,431)                      | 503,884                          |
| Private equity and other         | 36,948                   | 2,446                       | (694)                        | 38,700                           |
| Perpetual care trust investments | \$ 907,054               | \$ 43,798                   | \$ (2,692)                   | \$ 948,160                       |

|   |            |
|---|------------|
| Less: Assets associated with businesses held for sale | (54,229)   |
|   | \$ 893,931 |

Maturity dates of the fixed income securities range from 2007 to 2038. Maturities of fixed income securities at June 30, 2007 are estimated as follows:

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|                          | <b>Market<br/>(In<br/>thousands)</b> |
|--------------------------|--------------------------------------|
| Due in one year or less  | \$ 11,292                            |
| Due in one to five years | 28,325                               |
| Due in five to ten years | 15,182                               |
| Thereafter               | 13,771                               |
|                          | \$ 68,570                            |

During the three months ended June 30, 2007, purchases and sales of available-for-sale securities in the perpetual care trusts were \$58.6 million and \$51.7 million, respectively. These sale transactions resulted in \$18.9 million and \$5.0 million of realized gains and realized losses, respectively. During the three months ended June 30, 2006, purchases and sales of available-for-sale securities in the perpetual care trusts were \$145.9 million and \$150.3 million, respectively. These sales transactions resulted in \$2.4 million and \$4.7 million of realized gains and realized losses, respectively.

During the six months ended June 30, 2007, purchases and sales of available-for-sale securities in the perpetual care trusts were \$227.3 million and \$94.1 million, respectively. These sale transactions resulted in \$24.4 million and \$6.2 million of realized gains and realized losses, respectively. During the six months ended June 30, 2006, purchases and sales of available-for-sale securities in the perpetual care trusts were \$334.4 million and \$315.5 million, respectively. These sales transactions resulted in \$11.4 million and \$7.8 million of realized gains and realized losses, respectively.

Distributable earnings from these perpetual care trust investments are recognized in current cemetery revenues to the extent of qualifying cemetery maintenance costs. Recognized earnings related to these perpetual care trust investments were \$13.0 million and \$15.2 million for the three months ended June 30, 2007 and 2006, respectively. Recognized earnings related to these perpetual care trust investments were \$25.3 million and \$23.6 million for the six months ended June 30, 2007 and 2006, respectively.

### **9. Non-Controlling Interest in Funeral and Cemetery Trusts and in Cemetery Perpetual Care Trusts**

We consolidate the merchandise and service trusts associated with our preneed funeral and cemetery activities as a result of the implementation of FIN 46R. Although FIN 46R requires the consolidation of the merchandise and service trusts, it does not change the legal relationships among the trusts, our customers or us. The customers are the legal beneficiaries of these merchandise and service trusts, and therefore, their interests in these trusts represent a non-controlling interest in subsidiaries.

The components of *Non-controlling interest in funeral and cemetery trusts* and *Non-controlling interest in perpetual care trusts* in our condensed consolidated balance sheet at June 30, 2007 and December 31, 2006 are detailed below.

|   | <b>Preneed</b>        | <b>June 30, 2007<br/>Preneed</b> |              | <b>June 30, 2007<br/>Cemetery<br/>Perpetual<br/>Care</b> |
|---|-----------------------|----------------------------------|--------------|--|
|   | <b>Funeral</b>        | <b>Cemetery</b>                  | <b>Total</b> |  |
|   | <b>(In thousands)</b> |                                  |              |  |
| Trust investments, at market value                                  | \$ 1,353,765          | \$ 1,275,097                     | \$ 2,628,862 | \$ 958,947   |
| Less: Accrued trust operating payables,<br>deferred taxes and other | (7,129)               | (12,015)                         | (19,144)     | (3,589)  |
| Non-controlling interest  | \$ 1,346,636          | \$ 1,263,082                     | \$ 2,609,718 | \$ 955,358   |

|   | December 31, 2006  |                     |              | December 31,<br>2006       |
|---|--------------------|---------------------|--------------|----------------------------|
|   | Preneed<br>Funeral | Preneed<br>Cemetery | Total        | Cemetery<br>Perpetual Care |
|   | (In thousands)     |                     |              |                            |
| Trust investments, at market value                                  | \$ 1,329,922       | \$ 1,236,446        | \$ 2,566,368 | \$ 893,931                 |
| Less: Accrued trust operating payables,<br>deferred taxes and other | (6,052)            | (11,573)            | (17,625)     | (6,745)                    |
| Non-controlling interest  | \$ 1,323,870       | \$ 1,224,873        | \$ 2,548,743 | \$ 887,186                 |

**Table of Contents*****Other (Expense) Income, Net***

The components of *Other (expense) income, net* in our condensed consolidated statement of operations for the three and six months ended June 30, 2007 and 2006 are detailed below. See Notes 6 through 8 to the condensed consolidated financial statements for further discussion of the amounts related to the funeral, cemetery and perpetual care trusts.

|  | <b>Three Months Ended June 30, 2007</b> |                            |  |                       |              |
|--|---|----------------------------|--|-----------------------|--------------|
|  | <b>Funeral<br/>Trusts</b>               | <b>Cemetery<br/>Trusts</b> | <b>Cemetery<br/>Perpetual<br/>Care<br/>Trusts<br/>(In thousands)</b> | <b>Other,<br/>Net</b> | <b>Total</b> |
| Realized gains   | \$ 23,236                               | \$ 23,043                  | \$ 18,924  | \$                    | \$ 65,203    |
| Realized losses  | (9,226)                                 | (8,766)                    | (6,162)  |                       | (24,154)     |
| Interest, dividend and other ordinary income   | 6,540                                   | 7,085                      | 12,371   |                       | 25,996       |
| Trust expenses and income taxes  | (2,331)                                 | (4,869)                    | (1,393)  |                       | (8,593)      |
| Net trust investment income  | 18,219                                  | 16,493                     | 23,740   |                       | 58,452       |
| Interest expense related to non-controlling interest in funeral and cemetery trust investments | (18,219)                                | (16,493)                   |  |                       | (34,712)     |
| Interest expense related to non-controlling interest in perpetual care trust investments       |   |                            | (23,740)   |                       | (23,740)     |
| Total non-controlling interest   | (18,219)                                | (16,493)                   | (23,740)   |                       | (58,452)     |
| Other (expense), net   |   |                            |  | (723)                 | (723)        |
| Total other (expense), net   | \$                                      | \$                         | \$   | \$ (723)              | \$ (723)     |

|  | <b>Six Months Ended June 30, 2007</b> |                            |  |                       |              |
|--|---------------------------------------|----------------------------|--|-----------------------|--------------|
|  | <b>Funeral<br/>Trusts</b>             | <b>Cemetery<br/>Trusts</b> | <b>Cemetery<br/>Perpetual<br/>Care<br/>Trusts<br/>(In thousands)</b> | <b>Other,<br/>Net</b> | <b>Total</b> |
| Realized gains   | \$ 32,751                             | \$ 36,337                  | \$ 24,432  | \$                    | \$ 93,520    |
| Realized losses  | (15,637)                              | (15,619)                   | (7,383)  |                       | (38,639)     |
| Interest, dividend and other ordinary income   | 11,651                                | 14,693                     | 22,319   |                       | 48,663       |
| Trust expenses and income taxes  | (5,379)                               | (8,391)                    | (2,387)  |                       | (16,157)     |
| Net trust investment income  | 23,386                                | 27,020                     | 36,981   |                       | 87,387       |
| Interest expense related to non-controlling interest in funeral and cemetery trust investments | (23,386)                              | (27,020)                   |  |                       | (50,406)     |
|  |                                       |                            | (36,981)   |                       | (36,981)     |

Interest expense related to  
non-controlling interest in perpetual  
care trust investments

|                                |          |          |          |            |            |
|--------------------------------|----------|----------|----------|------------|------------|
| Total non-controlling interest | (23,386) | (27,020) | (36,981) |            | (87,387)   |
| Other (expense), net           |          |          |          | (2,932)    | (2,932)    |
| Total other (expense), net     | \$       | \$       | \$       | \$ (2,932) | \$ (2,932) |

**Three Months Ended June 30, 2006**

|  | <b>Funeral<br/>Trusts</b> | <b>Cemetery<br/>Trusts</b> | <b>Cemetery<br/>Perpetual<br/>Care<br/>Trusts<br/>(In thousands)</b> | <b>Other,<br/>Net</b> | <b>Total</b> |
|--|---------------------------|----------------------------|--|-----------------------|--------------|
| Realized gains   | \$ 15,408                 | \$ 17,691                  | \$ 2,397   | \$                    | \$ 35,496    |
| Realized losses  | (6,325)                   | (7,302)                    | (4,674)  |                       | (18,301)     |
| Interest, dividend and other ordinary<br>income  | 4,081                     | 6,837                      | 15,640   |                       | 26,558       |
| Trust expenses and income taxes  | (3,425)                   | (5,324)                    | (2,465)  |                       | (11,214)     |
| Net trust investment income  | 9,739                     | 11,902                     | 10,898   |                       | 32,539       |
| Interest expense related to<br>non-controlling interest in funeral and<br>cemetery trust investments | (9,739)                   | (11,902)                   |  |                       | (21,641)     |
| Interest expense related to<br>non-controlling interest in perpetual<br>care trust investments       |                           |                            | (10,898)   |                       | (10,898)     |
| Total non-controlling interest   | (9,739)                   | (11,902)                   | (10,898)   |                       | (32,539)     |
| Other income   |                           |                            |  | 66                    | 66           |
| Total other income, net  | \$                        | \$                         | \$   | \$ 66                 | \$ 66        |

**Six Months Ended June 30, 2006**

|  | <b>Funeral<br/>Trusts</b> | <b>Cemetery<br/>Trusts</b> | <b>Cemetery<br/>Perpetual<br/>Care<br/>Trusts<br/>(In thousands)</b> | <b>Other,<br/>Net</b> | <b>Total</b> |
|--|---------------------------|----------------------------|--|-----------------------|--------------|
| Realized gains   | \$ 33,804                 | \$ 34,523                  | \$ 11,403  | \$                    | \$ 79,730    |
| Realized losses  | (11,755)                  | (13,755)                   | (7,802)  |                       | (33,312)     |
| Interest, dividend and other ordinary<br>income                        | 8,156                     | 19,113                     | 23,724   |                       | 50,993       |
| Trust expenses and income taxes  | (3,066)                   | (5,389)                    | (140)  |                       | (8,595)      |
| Net trust investment income  | 27,139                    | 34,492                     | 27,185   |                       | 88,816       |
| Interest expense related to<br>non-controlling interest in funeral and | (27,139)                  | (34,492)                   |  |                       | (61,631)     |

|  |          |          |          |          |          |
|--|----------|----------|----------|----------|----------|
| cemetery trust investments   |          |          |          |          |          |
| Interest expense related to<br>non-controlling interest in perpetual<br>care trust investments |          |          | (27,185) |          | (27,185) |
| Total non-controlling interest   | (27,139) | (34,492) | (27,185) |          | (88,816) |
| Other income   |          |          |          | 1,058    | 1,058    |
| Total other income, net  | \$       | \$       | \$       | \$ 1,058 | \$ 1,058 |

**Table of Contents****10. Debt**

Debt as of June 30, 2007 and December 31, 2006 was as follows:

|  | <b>June 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|--------------------------|------------------------------|
|  | <b>(In thousands)</b>    |                              |
| 6.875% notes due October 2007  | \$ 13,497                | \$ 13,497                    |
| 6.5% notes due March 2008  | 45,209                   | 195,000                      |
| 7.7% notes due April 2009  | 28,731                   | 202,588                      |
| 7.875% debentures due February 2013  | 55,627                   | 55,627                       |
| 7.375% senior notes due October 2014   | 250,000                  | 250,000                      |
| 6.75% notes due April 2015   | 200,000                  |                              |
| 6.75% notes due April 2016   | 250,000                  | 250,000                      |
| 7.0% notes due June 2017   | 300,000                  | 300,000                      |
| 7.625% senior notes due October 2018   | 250,000                  | 250,000                      |
| 7.5% notes due April 2027  | 200,000                  |                              |
| Term loan due 2009   |                          | 100,000                      |
| Series A and Series B senior notes due November 2011   | 200,000                  | 200,000                      |
| Convertible debentures, maturities through 2013, fixed interest rates from 4.75% to 5.25%, conversion prices from \$13.02 to \$50.00 per share | 9,425                    | 9,925                        |
| Obligations under capital leases   | 120,327                  | 113,484                      |
| Mortgage notes and other debt, maturities through 2050   | 24,521                   | 26,304                       |
| Unamortized pricing discounts and other  | (6,182)                  | (7,553)                      |
| <b>Total debt</b>  | <b>1,941,155</b>         | <b>1,958,872</b>             |
| Less current maturities  | (103,837)                | (46,176)                     |
| <b>Total long-term debt</b>  | <b>\$ 1,837,318</b>      | <b>\$ 1,912,696</b>          |

Current maturities of debt at June 30, 2007 were comprised primarily of our 6.5% notes due March 2008 (see further discussion below in **Debt Extinguishments and Reductions**), our 6.875% notes due October 2007, convertible debentures, and capital leases. Our consolidated debt had a weighted average interest rate of 7.13% at June 30, 2007 and 7.30% at December 31, 2006. Approximately 87% and 82% of the total debt had a fixed interest rate at June 30, 2007 and December 31, 2006, respectively.

**Bank Credit Facility**

We entered into a new five-year \$450 million bank credit facility in November 2006 with a syndicate of financial institutions, comprised of a \$300 million revolving credit facility and a \$150 million term loan facility, including a sublimit of \$175 million for letters of credit. The term loan was funded under the credit facility. We repaid \$50 million of the term loan in December 2006 and the remaining \$100 million in the first quarter of 2007. The \$300 million revolving credit facility remains unfunded.

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The bank credit facility matures in November 2011. As of June 30, 2007, we have used the facility to support \$57.1 million of letters of credit. The credit facility provides us with flexibility for working capital cash, if needed, and is guaranteed by our domestic subsidiaries. The subsidiary guaranty is a guaranty of payment of the outstanding amount of the total lending commitment. It covers the term of the credit facility, including extensions, and totaled a maximum potential amount of \$57.1 million at June 30, 2007. The credit facility contains certain financial covenants, including a minimum interest coverage ratio, a maximum leverage ratio, maximum capital expenditure limitations, and certain cash distribution and share repurchase restrictions. As of June 30, 2007, we were in compliance with all of our debt covenants. We also pay a quarterly fee on the unused commitment, which ranges from 0.25% to 0.50%.

**Debt Issuances and Additions**

In April 2007, we completed a private offering of \$400.0 million aggregate principal unsecured senior notes, consisting of \$200.0 million aggregate principal amount of 6.75% Senior Notes due 2015 and \$200.0 million aggregate principal amount of 7.50% Senior Notes due 2027. We are entitled to redeem the notes at any time by paying a make-whole premium. The notes are subject to the provisions of our Senior Indenture dated as of February 1, 1993, as amended, which includes covenants limiting, among other things, the creation of liens securing indebtedness and sale-leaseback transactions. As of June 30, 2007, we were in compliance with all such debt covenants. We used the net proceeds from the offering to fund the closing of the tender offers for our 6.50% Notes due 2008 and 7.70% Notes due 2009 as further discussed below and for general corporate purposes. Under the terms of the registration rights agreement entered into in connection with the offerings of the notes, we filed a registration statement with the SEC with respect to an offer to exchange the notes for registered notes with substantially identical terms. The registration statement was declared effective by the SEC on July 11, 2007, and we intend to complete the offering to exchange on or about August 14, 2007.

**Debt Extinguishments and Reductions**

In the first quarter of 2007, we repaid \$100.0 million aggregate principal amount of our term loan. As a result of this transaction, we recognized a loss of \$2.4 million recorded in *Loss on early extinguishment of debt* in our condensed consolidated statement of operations, which represents the write-off of unamortized deferred loan costs of \$1.7 million and a \$0.7 million premium to early extinguish the debt.

In the second quarter of 2007, we purchased \$149.8 million aggregate principal amount of our 6.50% Notes due 2008 and \$173.8 million aggregate principal amount of our 7.70% Notes due 2009 in a tender offer. In connection with the repurchase of the notes, we recognized a *Loss on early extinguishment of debt* of approximately \$12.1 million, which represents the write-off of unamortized deferred loan costs of \$0.4 million, a \$1.0 million loss on a related interest rate hedge, and \$10.7 million in premiums paid to extinguish the debt.

**Capital Leases**

In the first half of 2007, we acquired \$23.9 million of transportation vehicles and other assets, which primarily relates to Alderwoods operations, using capital leases.

**11. Retirement Plans**

The components of net periodic pension plan benefit cost for the three and six months ended June 30 were as follows:

|   | Three months ended<br>June 30, |          | Six months ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
|   | 2007                           | 2006     | 2007                         | 2006     |
|   | (In thousands)                 |          |                              |          |
| Interest cost on projected benefit obligation | \$ 2,083                       | \$ 1,973 | \$ 4,166                     | \$ 3,946 |
| Actual return on plan assets                  | (909)                          | (1,589)  | (1,935)                      | (2,627)  |
| Amortization of prior service cost            | 46                             | 46       | 92                           | 92       |
|   | \$ 1,220                       | \$ 430   | \$ 2,323                     | \$ 1,411 |

During the third quarter of 2006, we initiated the process to terminate our cash balance plan. As a result, we expect to pay an estimated \$36.0 million to settle our liability in the second half of 2007.

**Table of Contents****12. Share-Based Compensation***Stock Benefit Plans*

We utilize the Black-Scholes valuation model for estimating the fair value of our stock options. This model allows the use of a range of assumptions related to volatility, the risk-free interest rate, the expected life, and the dividend yield. The fair values of our stock options are calculated using the following weighted average assumptions for the three and six months ended June 30, 2007:

**Assumptions**

|                         |           |
|-------------------------|-----------|
| Dividend yield          | 1.4%      |
| Expected volatility     | 38.9%     |
| Risk-free interest rate | 4.8%      |
| Expected holding period | 5.9 years |

*Stock Options*

The following table sets forth stock option activity for the six months ended June 30, 2007:

|                                  | <b>Options</b> | <b>Weighted-average<br/>exercise price</b> |
|----------------------------------|----------------|--|
| Outstanding at December 31, 2006 | 22,531,316     | \$ 7.79                                    |
| Granted                          | 2,080,400      | 10.73                                      |
| Exercised                        | (2,533,863)    | 5.48                                       |
| Expired                          | (3,346,605)    | 17.56                                      |
| Outstanding at June 30, 2007     | 18,731,248     | \$ 6.68                                    |
| Exercisable at June 30, 2007     | 15,262,741     | \$ 6.02                                    |

*Restricted Shares*

Restricted share activity for the six months ended June 30, 2007 was as follows:

|  | <b>Restricted<br/>shares</b> | <b>Weighted-average<br/>grant-date<br/>fair value</b> |
|--|------------------------------|---|
| Nonvested restricted shares at December 31, 2006 | 795,176                      | \$ 7.50   |
| Granted  | 313,800                      | 10.73   |
| Vested   | (402,992)                    | 7.29  |
| Nonvested restricted shares at June 30, 2007     | 705,984                      | \$ 9.08   |

**13. Stockholders Equity**

Our components of *Accumulated other comprehensive income* are as follows:

|                              | <b>Foreign<br/>currency<br/>translation<br/>adjustment</b> | <b>Pension<br/>related<br/>adjustments</b> | <b>Unrealized<br/>gains and<br/>losses</b> | <b>Accumulated<br/>other<br/>comprehensive<br/>income</b> |
|------------------------------|--|--|--|---|
|                              | <b>(In thousands)</b>                                      |  |  |   |
| Balance at December 31, 2006 | \$ 76,652  | \$ (623)                                   | \$ (3,731)                                 | \$ 72,298   |
| Activity in 2007             | 47,203   | 92   | (5,699)<br>(8,878)                         | 41,596<br>(8,878)   |

|   |            |          |            |       |         |
|---|------------|----------|------------|-------|---------|
| Increase in net unrealized losses associated with available-for-sale securities of the trusts         |            |          |            |       |         |
| Reclassification of net unrealized loss activity attributable to the non-controlling interest holders |            |          |            | 8,878 | 8,878   |
| Balance at June 30, 2007  | \$ 123,855 | \$ (531) | \$ (9,430) | \$    | 113,894 |

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The assets and liabilities of foreign operations are translated into U.S. dollars using the current exchange rate. The U.S. dollar amount that arises from such translation, as well as exchange gains and losses on intercompany balances of a long-term investment nature, are included in the cumulative currency translation adjustments in *Accumulated other comprehensive income*. Income taxes are generally not provided for foreign currency translation.

The components of Comprehensive income are as follows for the three and six months ended June 30, 2007 and 2006:

|                                  | <b>Three months ended</b> |             | <b>Six months ended</b> |             |
|----------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|                                  | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
|                                  | <b>(In thousands)</b>     |             |                         |             |
| Comprehensive income:            |                           |             |                         |             |
| Net income                       | \$ 15,118                 | \$ 25,450   | \$ 52,760               | \$ 52,376   |
| Total other comprehensive income | 37,190                    | 11,291      | 41,596                  | 10,961      |
| Comprehensive income             | \$ 52,308                 | \$ 36,741   | \$ 94,356               | \$ 63,337   |

**Cash Dividends**

On May 9, 2007, our Board of Directors approved a cash dividend of \$.03 per common share. At June 30, 2007, this dividend totaling \$8.8 million was recorded in *Accounts payable and accrued liabilities* and *Capital in excess of par value* in the condensed consolidated balance sheet. This dividend was subsequently paid on July 31, 2007. On August 8, 2007, our Board of Directors approved a cash dividend of \$.03 per common share.

**Share Repurchase Program**

Subject to market conditions and normal trading restrictions, we make purchases in the open market or through privately negotiated transactions under our stock repurchase program. In the six months ended June 30, 2007, we repurchased 8,025,808 shares of common stock at an aggregate cost of \$103.6 million and an average cost per share of \$12.91. After these purchases the remaining dollar value of shares authorized to be purchased under the share repurchase program was approximately \$97.1 million.

As of July 31, 2007, we repurchased 1,647,400 shares of common stock at an aggregate cost of \$20.9 million (average cost per share of \$12.68). In August, our Board of Directors approved an increase in our share repurchase program authorizing the investment of up to an additional \$200 million to repurchase our common stock. After these events, the remaining dollar value of shares authorized to be purchased under our share repurchase program was approximately \$276.2 million.

**14. Segment Reporting**

Our operations are both product based and geographically based, and the reportable operating segments presented below include our funeral and cemetery operations. Our geographic areas include United States and Foreign.

Alderwoods operating results are included in our 2007 results and have not been included as a pro forma adjustment to other periods. Please refer to Note 5 for pro forma presentations related to the Alderwoods acquisition.

Foreign operations consists of our operations in Canada and Germany. Results from our funeral business in Singapore, which was sold in the fourth quarter of 2006, are discontinued operations. We conduct both funeral and cemetery operations in the United States and Canada and funeral operations in Germany.

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Our reportable segment information is as follows:

|                                    | <b>Funeral</b> | <b>Cemetery<br/>(In thousands)</b> | <b>Reportable<br/>segments</b> |
|------------------------------------|----------------|------------------------------------|--------------------------------|
| Revenues from external customers:  |                |                                    |                                |
| Three months ended June 30,        |                |                                    |                                |
| 2007                               | \$375,754      | \$189,738                          | \$ 565,492                     |
| 2006                               | \$279,689      | \$151,711                          | \$ 431,400                     |
| Six months ended June 30,          |                |                                    |                                |
| 2007                               | \$798,730      | \$374,317                          | \$1,173,047                    |
| 2006                               | \$582,876      | \$290,525                          | \$ 873,401                     |
| Gross profit:                      |                |                                    |                                |
| Three months ended June 30,        |                |                                    |                                |
| 2007                               | \$ 70,538      | \$ 32,823                          | \$ 103,361                     |
| 2006                               | \$ 53,481      | \$ 30,707                          | \$ 84,188                      |
| Six months ended June 30,          |                |                                    |                                |
| 2007                               | \$172,935      | \$ 71,580                          | \$ 244,515                     |
| 2006                               | \$119,964      | \$ 52,918                          | \$ 172,882                     |
| Depreciation and amortization:     |                |                                    |                                |
| Three months ended June 30,        |                |                                    |                                |
| 2007                               | \$ 24,944      | \$ 5,802                           | \$ 30,746                      |
| 2006                               | \$ 16,250      | \$ 4,478                           | \$ 20,728                      |
| Six months ended June 30,          |                |                                    |                                |
| 2007                               | \$ 50,368      | \$ 11,764                          | \$ 62,132                      |
| 2006                               | \$ 32,664      | \$ 8,812                           | \$ 41,476                      |
| Amortization of cemetery property: |                |                                    |                                |
| Three months ended June 30,        |                |                                    |                                |
| 2007                               | \$             | \$ 9,587                           | \$ 9,587                       |
| 2006                               | \$             | \$ 6,874                           | \$ 6,874                       |
| Six months ended June 30,          |                |                                    |                                |
| 2007                               | \$             | \$ 17,800                          | \$ 17,800                      |
| 2006                               | \$             | \$ 12,743                          | \$ 12,743                      |
| Capital expenditures:              |                |                                    |                                |
| Six months ended June 30,          |                |                                    |                                |
| 2007                               | \$ 23,229      | \$ 34,938                          | \$ 58,167                      |
| 2006                               | \$ 14,419      | \$ 23,365                          | \$ 37,784                      |

The following table reconciles certain reportable segment amounts to corresponding consolidated amounts:

|                                | <b>Reportable<br/>Segments</b> | <b>Corporate</b> | <b>Consolidated</b> |
|--------------------------------|--------------------------------|------------------|---------------------|
| Depreciation and amortization: |                                |                  |                     |
| Three months ended June 30,    |                                |                  |                     |
| 2007                           | \$30,746                       | \$2,353          | \$33,099            |
| 2006                           | \$20,728                       | \$2,400          | \$23,128            |
| Six months ended June 30,      |                                |                  |                     |
| 2007                           | \$62,132                       | \$4,744          | \$66,876            |
| 2006                           | \$41,476                       | \$4,194          | \$45,670            |
| Capital expenditures           |                                |                  |                     |

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Six months ended June 30,

|      |          |         |          |
|------|----------|---------|----------|
| 2007 | \$58,167 | \$7,225 | \$65,392 |
| 2006 | \$37,784 | \$2,749 | \$40,533 |

The following table reconciles gross profit from reportable segments to our consolidated income from continuing operations before income taxes:

|  | <b>Three months ended</b> |             | <b>Six months ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
|  | <b>(In thousands)</b>     |             |                         |             |
| Gross profit from reportable segments                      | \$ 103,361                | \$ 84,188   | \$ 244,515              | \$ 172,882  |
| General and administrative expenses                        | (30,281)                  | (20,922)    | (65,680)                | (42,929)    |
| Gains (losses) on dispositions and impairment charges, net | 9,743                     | (2,881)     | 2,063                   | (7,391)     |
| Operating income   | 82,823                    | 60,385      | 180,898                 | 122,562     |
| Interest expense   | (36,165)                  | (26,609)    | (73,762)                | (53,337)    |
| Loss on early extinguishment of debt, net                  | (12,122)                  |             | (14,480)                |             |
| Interest income  | 2,478                     | 6,782       | 4,070                   | 12,763      |
| Equity in earnings of unconsolidated subsidiaries          | 5,559                     | 137         | 6,270                   | 137         |
| Other (expense) income, net                                | (723)                     | 66          | (2,932)                 | 1,058       |
| Income from continuing operations before income taxes      | \$ 41,850                 | \$ 40,761   | \$ 100,064              | \$ 83,183   |

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Our geographic area information is as follows:

|   | <b>United<br/>States</b> | <b>Foreign<br/>(In thousands)</b> | <b>Total</b> |
|---|--------------------------|-----------------------------------|--------------|
| Revenues from external customers:                           |                          |                                   |              |
| Three months ended June 30,                                 |                          |                                   |              |
| 2007  | \$ 519,596               | \$45,896                          | \$ 565,492   |
| 2006  | \$ 401,531               | \$29,869                          | \$ 431,400   |
| Six months ended June 30,                                   |                          |                                   |              |
| 2007  | \$1,080,888              | \$92,159                          | \$1,173,047  |
| 2006  | \$ 813,530               | \$59,871                          | \$ 873,401   |
| Gains (losses) on dispositions and impairment charges, net: |                          |                                   |              |
| Three months ended June 30,                                 |                          |                                   |              |
| 2007  | \$ 10,279                | \$ (536)                          | \$ 9,743     |
| 2006  | \$ (2,827)               | \$ (54)                           | \$ (2,881)   |
| Six months ended June 30,                                   |                          |                                   |              |
| 2007  | \$ 2,576                 | \$ (513)                          | \$ 2,063     |
| 2006  | \$ (5,832)               | \$ (1,559)                        | \$ (7,391)   |
| Operating income:   |                          |                                   |              |
| Three months ended June 30,                                 |                          |                                   |              |
| 2007  | \$ 81,400                | \$ 1,423                          | \$ 82,823    |
| 2006  | \$ 55,006                | \$ 5,379                          | \$ 60,385    |
| Six months ended June 30,                                   |                          |                                   |              |
| 2007  | \$ 175,610               | \$ 5,288                          | \$ 180,898   |
| 2006  | \$ 112,521               | \$10,041                          | \$ 122,562   |
| Depreciation and amortization:                              |                          |                                   |              |
| Three months ended June 30,                                 |                          |                                   |              |
| 2007  | \$ 29,504                | \$ 3,595                          | \$ 33,099    |
| 2006  | \$ 21,458                | \$ 1,670                          | \$ 23,128    |
| Six months ended June 30,                                   |                          |                                   |              |
| 2007  | \$ 59,253                | \$ 7,623                          | \$ 66,876    |
| 2006  | \$ 42,381                | \$ 3,289                          | \$ 45,670    |
| Amortization of cemetery property:                          |                          |                                   |              |
| Three months ended June 30,                                 |                          |                                   |              |
| 2007  | \$ 8,932                 | \$ 655                            | \$ 9,587     |
| 2006  | \$ 6,212                 | \$ 662                            | \$ 6,874     |
| Six months ended June 30,                                   |                          |                                   |              |
| 2007  | \$ 16,829                | \$ 971                            | \$ 17,800    |
| 2006  | \$ 11,585                | \$ 1,158                          | \$ 12,743    |

Depreciation expense related to property, plant, and equipment totaled \$29.4 million and \$59.4 million for the three and six months ended June 30, 2007, respectively, and \$20.0 million and \$39.4 million for the three and six months ended June 30, 2006, respectively.

**Table of Contents****15. Supplementary Information**

The detail of certain income statement accounts as presented in the condensed consolidated statement of operations is as follows for the three and six months ended June 30:

|                                | <b>Three months ended</b> |             | <b>Six months ended</b> |             |
|--------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|                                | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
|                                | <b>(In thousands)</b>     |             |                         |             |
| Merchandise revenues           |                           |             |                         |             |
| Funeral                        | \$ 127,066                | \$ 103,793  | \$ 273,931              | \$ 224,622  |
| Cemetery                       | 128,909                   | 97,324      | 248,230                 | 186,776     |
| Total merchandise revenues     | 255,975                   | 201,117     | 522,161                 | 411,398     |
| Services revenues              |                           |             |                         |             |
| Funeral                        | 236,199                   | 165,598     | 502,159                 | 338,456     |
| Cemetery                       | 52,701                    | 46,531      | 109,460                 | 87,746      |
| Total services revenues        | 288,900                   | 212,129     | 611,619                 | 426,202     |
| Other revenues                 | 20,617                    | 18,154      | 39,267                  | 35,801      |
| Total revenues                 | \$ 565,492                | \$ 431,400  | \$ 1,173,047            | \$ 873,401  |
| Costs and expenses             |                           |             |                         |             |
| Merchandise costs and expenses |                           |             |                         |             |
| Funeral                        | \$ 64,193                 | \$ 48,069   | \$ 135,949              | \$ 104,718  |
| Cemetery                       | 55,440                    | 41,614      | 102,000                 | 78,957      |
| Total cost of merchandise      | 119,633                   | 89,683      | 237,949                 | 183,675     |
| Services costs and expenses    |                           |             |                         |             |
| Funeral                        | 122,337                   | 89,073      | 241,246                 | 178,799     |
| Cemetery                       | 29,347                    | 24,136      | 57,182                  | 47,613      |
| Total cost of services         | 151,684                   | 113,209     | 298,428                 | 226,412     |
| Overhead and other expenses    | 190,814                   | 144,320     | 392,155                 | 290,432     |
| Total costs and expenses       | \$ 462,131                | \$ 347,212  | \$ 928,532              | \$ 700,519  |

**Table of Contents****16. Commitments and Contingencies****Representations and Warranties**

As of June 30, 2007, we have contingent obligations of \$33.1 million resulting from our previous international asset sales and joint venture transactions. In some cases, we have agreed to guarantee certain representations and warranties made in such disposition transactions with letters of credit or interest-bearing cash investments. We have interest-bearing cash investments of \$9.6 million included in *Deferred charges and other assets* collateralizing certain of these contingent obligations. We believe it is remote that we will ultimately be required to fund to third parties claims against these representations and warranties above the carrying value of the liability.

In March 2004, we disposed of our funeral operations in France to a newly formed, third party company. As a result of this sale, we recognized \$35.8 million of contractual obligations related to representations, warranties, and other indemnifications. During the first half of 2007, we paid \$0.2 million to settle certain tax and litigation matters. The remaining obligation of \$23.5 million at June 30, 2007 represents the following:

|   | <b>Contractual<br/>Obligation<br/>(In<br/>thousands)</b> | <b>Time Limit</b>  | <b>Maximum<br/>Potential<br/>Amount of<br/>Future<br/>Payments</b> | <b>Carrying<br/>Value as of<br/>June 30,<br/>2007<br/>(In<br/>thousands)</b> |
|---|--|--|--|--|
| Tax reserve liability                     | \$ 18,610  | December 31, 2007  | 30 million   | 10,000   |
| Litigation provision                      | 7,765  | Until entire resolution of (i) the relevant claims or (ii) settlement of the claim by the purchaser at the request of the vendor | (1)  | 4,120  |
| Employee litigation provision             | 6,512  | One month after expiration of the statutory period of limitations  | (2)  | 6,512  |
| VAT taxes                                 | 3,882  | One month after expiration of the statutory period of limitations  | (1)  | 3,882  |
| Other                                     | 3,381  | Until entire resolution of (i) the relevant claims or (ii) settlement of the claim by the purchaser at the request of the vendor | (2)  | 3,381  |
| Total                                     | \$ 40,150  |  |  | \$ 27,895  |
| Less: Deductible of majority equity owner | (4,382)  |  |  | (4,382)  |
|   | \$ 35,768  |  |  | \$ 23,513  |

(1) The potential maximum exposure for these two items combined is 20.0 million or \$27.0 million at

June 30, 2007.

- (2) The potential maximum exposure for these two items combined is 40.0 million or \$54.0 million at June 30, 2007.

**Litigation**

We are a party to various litigation matters, investigations, and proceedings. For each of our outstanding legal matters, we evaluate the merits of the case, our exposure to the matter, possible legal or settlement strategies, and the likelihood of an unfavorable outcome. We intend to defend ourselves in the lawsuits described herein; however, if we determine that an unfavorable outcome is probable and can be reasonably estimated, we establish the necessary accruals. We hold certain insurance policies that may reduce cash outflows with respect to an adverse outcome of certain of these litigation matters. We accrue such insurance recoveries when they become probable of being paid and can be reasonably estimated.

*Conley Investment Counsel v. Service Corporation International, et al*; Civil Action 04-MD-1609; In the United States District Court for the Southern District of Texas, Houston Division (the 2003 Securities Lawsuit ). The 2003 Securities Lawsuit resulted from the transfer and consolidation by the Judicial Panel on Multidistrict Litigation of three lawsuits *Edgar Neufeld v. Service Corporation International, et al*; Cause No. CV-S-03-1561-HDM-PAL; In the United States District Court for the District of Nevada; and *Rujira Srisythemp v. Service Corporation International, et. Al.*; Cause No. CV-S-03-1392-LDG-LRL; In the United States District Court for the District of Nevada; and *Joshua Ackerman v. Service Corporation International, et. Al.*; Cause No. 04-CV-20114; In the United States District Court for the Southern District of Florida. The 2003 Securities Lawsuit names as defendants SCI and several of

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SCI's current and former executive officers or directors. The 2003 Securities Lawsuit is a purported class action alleging that the defendants failed to disclose the unlawful treatment of human remains and gravesites at two cemeteries in Fort Lauderdale and West Palm Beach, Florida. Since the action is in its preliminary stages, no discovery has occurred, and we cannot quantify our ultimate liability, if any, for the payment of damages.

*Burial Practices Claims.* We are named as a defendant in various lawsuits alleging improper burial practices at certain of our cemetery locations, and have been notified by other potential claimants that additional lawsuits with similar allegations may be filed against us. These lawsuits include the *Valls* and *Garcia* lawsuits described in the following paragraphs.

*Maria Valls, Pedro Valls and Roberto Valls, on behalf of themselves and all other similarly situated v. SCI Funeral Services of Florida, Inc. d/b/a Memorial Plan a/k/a Flagler Memorial Park, John Does and Jane Does*; Case No. 23693CA08; In the Circuit Court of the 11th Judicial Circuit in and for Miami-Dade County, Florida ( *Valls Lawsuit* ). The *Valls Lawsuit* was filed December 5, 2005, and named a subsidiary of SCI as a defendant. An amended complaint was filed on May 31, 2006. Plaintiffs have requested that the court certify this matter as a class action. The plaintiffs allege the defendants improperly handled remains, did not keep adequate records of interments, and engaged in various other improprieties in connection with the operation of the cemetery. Although the plaintiffs seek to certify as a class all family members of persons buried at the cemetery, the court dismissed plaintiffs' class action allegations; however, the dismissal was without prejudice and plaintiffs have filed an amended complaint which we are contesting. The plaintiffs are seeking monetary damages and have reserved the right to seek leave from the court to claim punitive damages. The plaintiffs are also seeking injunctive relief. Since the action is in its preliminary stages, we cannot quantify our ultimate liability, if any, for the payment of any damages.

In addition to the *Valls Lawsuit*, we have met with separate counsel representing other families who have made burial practices claims related to this cemetery. In cooperation with the families, our cemetery management initiated an investigation into certain of the families' claims. We are working with the families and their counsel for the purpose of resolving these claims. No lawsuit has been filed and we cannot quantify our ultimate liability, if any, for the payment of any damages.

*Reyvis Garcia and Alicia Garcia v. Alderwoods Group, Inc., Osiris Holding of Florida, Inc, a Florida corporation, d/b/a Graceland Memorial Park South, f/k/a Paradise Memorial Gardens, Inc.*, was filed in December 2004, in the Circuit Court of the Eleventh Judicial Circuit in and for Miami-Dade County, Florida, Case No.: 04-25646 CA 32. Plaintiffs are the son and sister of the decedent, Eloisa Garcia, who was buried at Graceland Memorial Park South in March 1986, when the cemetery was owned by Paradise Memorial Gardens, Inc. Initially, the suit sought damages on the individual claims of the plaintiffs relating to the burial of Eloisa Garcia. Plaintiffs claimed that due to poor record keeping, spacing issues and maps, and the fact that the family could not afford to purchase a marker for the grave, the burial location of the decedent could not be readily located. Subsequently, the decedent's grave was located and verified. In July 2006, plaintiffs amended their complaint, seeking to certify a class of all persons buried at this cemetery whose burial sites cannot be located, claiming that this is due to poor record keeping, maps, and surveys at the cemetery. The plaintiffs are seeking unspecified monetary damages, as well as equitable and injunctive relief. No class has been certified in this matter. Since the action is in its preliminary stages, we cannot quantify our ultimate liability, if any, for the payment of any damages.

*Funeral Regulations Lawsuits.* We are named as a defendant in various lawsuits alleging violations of federal and state funeral related regulations and/or statutes, including the *Hijar*, *Baudino*, and *Sanchez* lawsuits described in the following paragraphs.

*David Hijar v. SCI Texas Funeral Services, Inc., SCI Funeral Services, Inc., and Service Corporation International*; In the County Court of El Paso, County, Texas, County Court at Law Number Three; Cause Number 2002-740, with an interlocutory petition for review (No. 07-0210) and a mandamus proceeding pending (No. 06-0385) in the Texas Supreme Court (collectively, the *Hijar Lawsuit* ). The *Hijar Lawsuit* involves a state-wide class action brought on behalf of all persons, entities, and organizations who purchased funeral services from SCI or its subsidiaries in Texas at any time since March 18, 1998. Plaintiffs allege that federal and Texas funeral related regulations and/or statutes ( *Rules* ) required us to disclose our markups on all items obtained from third parties in connection with funeral service contracts and that the failure to make certain disclosures of markups resulted in breach

of contract and other legal claims. The plaintiffs seek to recover an unspecified amount of monetary damages. The plaintiffs also seek attorneys' fees, costs of court, pre- and post-judgment interest, and unspecified injunctive and declaratory relief. We deny that the plaintiffs have standing to sue for violations of the Texas Occupations Code or the Rules, deny that plaintiffs have standing to sue for violations under the relevant regulations and statutes, deny that any breaches of contractual terms occurred, and on other grounds deny liability on all of the plaintiffs' claims. We deny that the Hjar Lawsuit satisfies the requirements for class certification.

In May 2004, the trial court heard summary judgment cross-motions filed by us and plaintiff Hjar (at that time, the only plaintiff). The trial court granted Hjar's motion for partial summary judgment and denied our motion. In its partial summary judgment order, the trial court made certain findings to govern the case, consistent with its summary judgment ruling. Our request for rehearing was denied.

During the course of the Hjar Lawsuit, the parties have disputed the proper scope and substance of discovery. Following briefing by both parties and evidentiary hearings, the trial court entered three orders against us that are the subject of appellate review: (a) a

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January 2005 discovery sanctions order; (b) an April 2005 discovery sanctions order; and (c) an April 2005 certification order, certifying a class and two subclasses. On April 29, 2005, we filed an appeal regarding the certification order and, concurrently with our initial brief in that appeal, filed a separate mandamus proceeding regarding the sanctions orders.

In the certification appeal the court of appeals issued an opinion holding that the plaintiffs do not have a private right of action for monetary damages under the relevant regulations and statutes. The opinion concludes that the plaintiffs do not have standing to assert their claims for monetary damages on behalf of themselves or the class. The court of appeals therefore reversed the trial court's order certifying a class, rendered judgment against the plaintiffs on their claims for damages, and remanded the remaining general individual claims for injunctive relief back to the trial court (without opining on the merits of those claims) for further handling consistent with the court's opinion. Plaintiffs filed a motion for rehearing on August 11, 2006. On January 11, 2007, in response to the motion, the court of appeals issued a substitute opinion in which the court revised a portion of its discussion but reached the same result on certification (i.e., the class was decertified). Plaintiffs' second motion for rehearing was denied by the court of appeals on March 7, 2007. On March 20, 2007, plaintiffs filed a petition for review in the Supreme Court of Texas. The Supreme Court of Texas requested that we file a response to the petition for review. Our response is due to be filed in August 2007.

In the mandamus proceeding, the court of appeals denied the mandamus petition in January 2006, and denied rehearing on March 15, 2006. We filed a petition for writ of mandamus in the Supreme Court of Texas, which on September 11, 2006 requested full briefing on the merits. We filed our brief on the merits on November 10, 2006; plaintiffs filed their brief on the merits on November 30, 2006; and we filed our reply on the merits on December 15, 2006. The court has not yet taken further action in the mandamus proceeding.

*Mary Louise Baudino, et al v. Service Corporation International, et al*; the plaintiffs' counsel in the Hajar Lawsuit initiated an arbitration claim raising similar issues in California and filed in November 2004 a case styled *Mary Louise Baudino, et al v. Service Corporation International, et al*; in Los Angeles County Superior Court; Case No. BC324007 ( Baudino Lawsuit ). The Baudino Lawsuit makes claims similar to those made in the Hajar lawsuit. However, the Baudino Lawsuit seeks a nation-wide class of plaintiffs. On September 15, 2006, the trial court granted our motion for summary judgment on the merits of plaintiffs' claims. Plaintiffs are appealing the summary judgment ruling.

*Richard Sanchez et al v Alderwoods Group, Inc. et al* was filed in February 2005 in the Superior Court of the State of California, for the County of Los Angeles, Central District; Case No. BC328962. Plaintiffs seek to certify a nationwide class on behalf of all consumers who purchased funeral goods and services from Alderwoods. Plaintiffs allege in essence that the Federal Trade Commission's Funeral Rule requires Alderwoods to disclose its markups on all items obtained from third-parties in connection with funeral service contracts. Plaintiffs allege further that Alderwoods has failed to make such disclosures. Plaintiffs seek to recover an unspecified amount of monetary damages, attorney's fees, costs, and unspecified injunctive and declaratory relief. This case is substantially similar to the Baudino Lawsuit, and we expect that the outcome of this case will be governed by the law applied in the Baudino Lawsuit.

*Antitrust Claims.* We are named as a defendant in two related class action antitrust cases filed in 2005. The first case is Cause No 4:05-CV-03394; *Funeral Consumers Alliance, Inc. v. Service Corporation International, et al*; In the United States District Court for the Southern District of Texas - Houston ( Funeral Consumers Case ). This is a purported class action on behalf of casket consumers throughout the United States alleging that we and several other companies involved in the funeral industry violated federal antitrust laws and state consumer laws by engaging in various anti-competitive conduct associated with the sale of caskets.

The second case is Cause No. 4:05-CV-03399; *Pioneer Valley Casket, et al. v. Service Corporation International, et al.*; In the United States District Court for the Southern District of Texas - Houston Division ( Pioneer Valley Case ). This lawsuit makes the same allegations as the Funeral Consumers Case and is also brought against several other companies involved in the funeral industry. Unlike the Funeral Consumers Case, the Pioneer Case is a purported class action on behalf of all independent casket distributors that are in the business or were in the business any time between July 18, 2001 to the present.

The Funeral Consumers Case and the Pioneer Valley Case seek injunctions, monetary damages, and treble damages. The plaintiffs in the Funeral Consumers Case filed an expert report indicating that the damages sought from all defendants range from approximately \$950 million to \$1.5 billion, before trebling. Additionally, the plaintiffs in the Pioneer Valley Case filed an expert report indicating that the damages sought from all defendants would be approximately \$99 million, before trebling. We deny that we engaged in anticompetitive practices related to our casket sales and intend to vigorously contest these claims and plaintiffs' damages reports. In both cases, we have filed reports of our experts which vigorously dispute the validity of the plaintiffs' damages theories and calculations. Since the litigation is in its preliminary stages, we cannot quantify our ultimate liability, if any, for the payment of damages.

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In addition to the Funeral Consumers Case and the Pioneer Valley Case, we received Civil Investigative Demands, dated August 2005 and February 2006, from the Attorney General of Maryland on behalf of itself and other state attorneys general, who have commenced an investigation of alleged anticompetitive practices in the funeral industry. We have also received similar Civil Investigative Demands from the Attorneys General of Florida and Connecticut.

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*Prise, et al., v. Alderwoods Group, Inc., and Service Corporation International*; Cause No. 06-164; In the United States District Court for the Western District of Pennsylvania (the Wage and Hour Lawsuit). The Wage and Hour Lawsuit was filed by two former Alderwoods (Pennsylvania), Inc., employees in December 2006 and purports to have been brought under the Fair Labor Standards Act (FLSA) on behalf of all Alderwoods and SCI affiliated employees who performed work for which they were not fully compensated, including work for which overtime pay was owed. The court has conditionally certified a class of claims as to certain job positions for Alderwoods employees. Further hearings will be held regarding conditional certification of claims against SCI.

Plaintiffs allege causes of action for violations of the FLSA, failure to maintain proper records, breach of contract, violations of state wage and hour laws, unjust enrichment, fraud and deceit, quantum meruit, negligent misrepresentation, and negligence. Plaintiffs seek injunctive relief, unpaid wages, liquidated, compensatory, consequential and punitive damages, attorneys' fees and costs, and pre- and post-judgment interest. The Wage and Hour Lawsuit is in its preliminary stages, no discovery has occurred, and we cannot quantify our ultimate liability, if any.

*Prise, et al., v. Alderwoods Group, Inc., and Service Corporation International*; Cause No. RG7384642; In the Superior Court of the State of California, county of Alameda. This lawsuit is related to the Wage and Hour Lawsuit and was filed in July 2007. It raises state law claims that were previously dismissed by the court in the Wage and Hour Lawsuit. This lawsuit is in its preliminary stages, and we cannot quantify our ultimate liability, if any, for the payment of any damages.

The ultimate outcome of the matters described above cannot be determined at this time. We intend to aggressively defend all of the above lawsuits; however, an adverse decision in one or more of such matters could have a material adverse effect on us, our financial condition, results of operations, and cash flows.

**17. Earnings Per Share**

Basic earnings per common share (EPS) excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other obligations to issue common stock were exercised or converted into common stock or resulted in the issuance of common shares that then shared in our earnings.

A reconciliation of the numerators and denominators of the basic and diluted EPS computations is presented below:

|   | <b>Three months ended</b>                       |             | <b>Six months ended</b> |             |
|---|---|-------------|-------------------------|-------------|
|   | <b>June 30,</b>                                 |             | <b>June 30,</b>         |             |
|   | <b>2007</b>                                     | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
|   | <b>(In thousands, except per share amounts)</b> |             |                         |             |
| Numerator:                                      |   |             |                         |             |
| Income from continuing operations               | \$ 12,909                                       | \$ 25,357   | \$ 47,626               | \$ 52,134   |
| Income from discontinued operations, net of tax | 2,209   | 93          | \$ 5,134                | 242         |
| Net income                                      | \$ 15,118                                       | \$ 25,450   | \$ 52,760               | \$ 52,376   |
| Denominator:                                    |   |             |                         |             |
| Weighted average shares basic                   | 290,577   | 293,409     | 291,941                 | 293,580     |
| Stock options                                   | 5,361   | 3,981       | 5,318                   | 4,063       |
| Restricted stock                                | 186   | 111         | 221                     | 141         |
| Weighted average shares diluted                 | 296,124   | 297,501     | 297,480                 | 297,784     |
| Income from continuing operations per share:    |   |             |                         |             |
| Basic   | \$ .04  | \$ .09      | \$ .16                  | \$ .18      |

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|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Diluted  | \$ .04 | \$ .09 | \$ .16 | \$ .18 |
| Income from discontinued operations per share, net of tax: |        |        |        |        |
| Basic  | \$ .01 | \$ .02 | \$ .02 | \$ .02 |
| Diluted  | \$ .01 | \$ .02 | \$ .02 | \$ .02 |
| Net income per share:                                      |        |        |        |        |
| Basic  | \$ .05 | \$ .09 | \$ .18 | \$ .18 |
| Diluted  | \$ .05 | \$ .09 | \$ .18 | \$ .18 |

The computation of diluted EPS excludes outstanding stock options and convertible debt in certain periods in which the inclusion of such options and debt would be antidilutive in the periods presented. Total options and convertible debentures not currently included in the computation of dilutive EPS are as follows (in shares):

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|  | <b>Three months ended<br/>June 30,</b> |             | <b>Six months ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2007</b>                            | <b>2006</b> | <b>2007</b>                          | <b>2006</b> |
|  | <b>(In thousands)</b>                  |             |                                      |             |
| Antidilutive options                                     | 1,622                                  | 8,237       | 1,559                                | 7,911       |
| Antidilutive convertible debentures                      | 307                                    | 633         | 312                                  | 646         |
| Total common stock equivalents excluded from computation | 1,929                                  | 8,870       | 1,871                                | 8,557       |

**18. Divestiture-Related Activities**

As dispositions occur in the normal course of business, gains or losses on the sale of such businesses are recognized in the income statement line item *Gains (losses) on dispositions and impairment charges, net*. Additionally, as dispositions occur pursuant to our ongoing asset sale programs, adjustments are made through this income statement line item to reflect the difference between actual proceeds received from the sale compared to the original estimates.

*Gains (losses) on dispositions and impairment charges, net* consists of the following for the three and six months ended June 30:

|   | <b>Three months ended<br/>June 30,</b> |             | <b>Six months ended<br/>June 30,</b> |             |
|---|--|-------------|--------------------------------------|-------------|
|   | <b>2007</b>                            | <b>2006</b> | <b>2007</b>                          | <b>2006</b> |
|   | <b>(In thousands)</b>                  |             |                                      |             |
| Gains on dispositions, net                | \$ 28,851                              | \$ 1,708    | \$ 21,206                            | \$ 3,140    |
| Impairment losses on assets held for sale | (19,108)                               | (4,589)     | (19,143)                             | (10,531)    |
|   | \$ 9,743                               | \$ (2,881)  | \$ 2,063                             | \$ (7,391)  |

In connection with the acquisition of Alderwoods, we have agreed to a consent order with the staff of the Federal Trade Commission (FTC) that identifies certain properties the FTC has required us to divest as a result of the acquisition. In the second quarter of 2007, we divested 50 of these properties. We have divested or expect to divest of the remaining five properties in the third quarter of 2007.

**Assets Held for Sale**

In addition, we have committed to a plan to sell certain other operating properties. As a result, these properties, along with the remainder of those expected to be sold as a result of the FTC agreement, have been classified as assets held for sale in our June 30, 2007 and December 31, 2006 consolidated balance sheets.

Net assets held for sale were as follows:

|  | <b>June 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|--------------------------|------------------------------|
|  | <b>(In thousands)</b>    |                              |
| Assets:  |                          |                              |
| Current assets                                     | \$ 3,033                 | \$ 6,330                     |
| Preneed funeral receivables and trust investments  | 19,612                   | 56,968                       |
| Preneed cemetery receivables and trust investments | 73,211                   | 107,796                      |
| Cemetery property                                  | 22,436                   | 65,448                       |
| Property and equipment, at cost (net)              | 24,166                   | 23,829                       |
| Deferred charges and other assets                  | 12,248                   | 13,914                       |

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|   |           |    |         |
|---|-----------|----|---------|
| Goodwill  |           |    | 27,127  |
| Cemetery perpetual care trust investments         | 17,734    |    | 54,229  |
| Total assets                                      | 172,440   |    | 355,641 |
| Liabilities:                                      |           |    |         |
| Accounts payable and accrued liabilities          | 157       |    | 419     |
| Deferred preneed funeral revenues                 | 18,565    |    | 66,841  |
| Deferred preneed cemetery revenues                | 79,586    |    | 117,604 |
| Other liabilities                                 | 276       |    | 1,126   |
| Non-controlling interest in perpetual care trusts | 17,734    |    | 54,229  |
| Total liabilities                                 | 116,318   |    | 240,219 |
| Net assets held for sale                          | \$ 56,122 | \$ | 115,422 |

**Table of Contents****Equity Investment**

In the third quarter of 2007, we entered into a contract to sell our 25% equity interest in our French operations, which we anticipate will generate sales proceeds of approximately \$170 million based on current exchange rates. We expect the closing to occur in the second half of 2007.

**Sale of Operations in Chile**

In September 2005, we completed the sale of our cemetery operations in Chile for proceeds of approximately \$106 million. We received net cash proceeds of \$90.0 million upon completion of the sale and received additional cash proceeds of CLP 5.8 billion or approximately \$11.0 million in 2006. In the first quarter of 2007, we received the remainder of the proceeds totaling CLP 2.5 billion or approximately \$4.7 million.

**Discontinued Operations**

As part of the Alderwoods transaction, we acquired an insurance subsidiary for which, as of June 30, 2007, we had entered into a definitive agreement to sell, and which we sold in July 2007 for approximately \$67.5 million. We recognized a \$2.4 million gain related to this business in the second quarter of 2007. The operations of this subsidiary are presented as discontinued operations in our condensed consolidated statement of operations and as assets and liabilities of discontinued operations on our condensed consolidated balance sheet.

During the fourth quarter of 2006, we divested our funeral operations in Singapore. During the third quarter of 2005, we also divested our cemetery operations in Chile. Accordingly, the operations in these countries are classified as discontinued operations for all periods presented.

The results of our discontinued operations for the three and six months ended June 30, 2007 and 2006 were as follows:

|   | <b>Three months ended<br/>June 30,</b> |             | <b>Six months ended<br/>June 30,</b> |             |
|---|--|-------------|--------------------------------------|-------------|
|   | <b>2007</b>                            | <b>2006</b> | <b>2007</b>                          | <b>2006</b> |
|   | <b>(In thousands)</b>                  |             |                                      |             |
| Revenues  | \$ 17,162                              | \$ 1,480    | \$ 42,626                            | \$ 2,794    |
| Costs and other expenses                                | (14,646)                               | (1,400)     | (36,448)                             | (2,469)     |
| Other income  | 916                                    |             | 916                                  |             |
| Income from discontinued operations before income taxes | 3,432                                  | 80          | 7,094                                | 325         |
| (Provision) benefit for income taxes                    | (1,223)                                | 13          | (1,960)                              | (83)        |
| Income from discontinued operations                     | \$ 2,209                               | \$ 93       | \$ 5,134                             | \$ 242      |

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****The Company**

We are North America's leading provider of deathcare products and services, with a network of funeral homes and cemeteries unequalled in geographic scale and reach. Our operations in North America are located in the United States and Canada.

Our acquisition of Alderwoods allows us to serve a number of new, complementary areas, while enabling us to capitalize on significant synergies and operating efficiencies. Several areas where cost-saving synergies have been quickly realized include the elimination of duplicate information technology systems and infrastructure, duplicate accounting, finance, legal, and other systems, overlapping management, and duplicate executive and public company costs. We also have begun to realize synergies in funeral and cemetery operations, including improved purchasing leverage and revenue enhancements.

We currently have approximately \$70.2 million authorized to repurchase our common stock, subject to bank covenant restrictions. Our financial stability is further enhanced by our \$6.5 billion backlog of future revenues at June 30, 2007, which is the result of preneed funeral and cemetery sales. We have the financial strength and flexibility

to reward shareholders through dividends while maintaining a prudent capital structure and pursuing new opportunities for profitable growth.

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### **Strategies for Growth**

In recent years, we have strengthened our balance sheet, lowered our cost structure, introduced more efficient systems and processes and strengthened our management team. We believe these improvements, together with our acquisition of Alderwoods, present us with significant opportunities to achieve future growth. Our principal strategies are as follows:

*Approach the business by customer preference;*

*Realign pricing to reflect current market environment;*

*Drive operating discipline and take advantage of our scale; and*

*Manage and grow the footprint.*

For additional information on these strategies, see our Annual Report on Form 10-K for the year ended December 31, 2006.

### **Financial Condition, Liquidity and Capital Resources**

#### ***Capital Allocation Considerations***

We rely on cash flow from operations as a significant source of liquidity. In addition, we have approximately \$242.9 million in borrowing capacity under our 5-year, \$300.0 million revolving credit facility (which is currently supporting \$57.1 million of letters of credit). We believe these sources of liquidity, along with the proceeds from divestitures discussed below, can be supplemented by our ability to access the capital markets.

In connection with our acquisition of Alderwoods, we agreed to sell certain properties pursuant to an agreement with the staff of the Federal Trade Commission (FTC). In addition, we have committed to a plan to sell certain other operating properties. In the first half of 2007, we generated \$193.7 million of proceeds from divestitures of these properties, which included 50 FTC mandated properties. We have divested or expect to divest the remaining five FTC mandated properties in the third quarter of 2007. In addition, we sold Mayflower National Life Insurance Company, Alderwoods former insurance subsidiary, for \$67.5 million in July 2007. Additionally, in the third quarter of 2007, we entered into a contract to sell our 25% equity interest in our French operations, which we anticipate will generate sales proceeds of approximately \$170 million based on current exchange rates. We anticipate the closing to occur in the second half of 2007.

At June 30, 2007, our current liabilities exceeded our current assets as a result of using \$608 million of available cash in the Alderwoods transaction. We believe our future operating cash flows and the available capacity under our credit facility will be adequate to meet our working capital needs.

#### ***Cash Flow***

We believe our ability to generate strong operating cash flow is one of our fundamental financial strengths and provides us with substantial flexibility in meeting operating and investing needs. Highlights of cash flow for the six months ended June 30, 2007 and 2006 are as follows:

***Operating Activities*** Cash flows from operating activities in the first six months of 2007 were \$191.6 million compared to \$151.6 million in the first six months of 2006. Included in the first six months of 2007 are one-time transition and related to the Alderwoods acquisition and integration of \$19.5 million and \$11.4 million of premiums paid on the early extinguishment of debt. Excluding the above items, cash flow from operations increased approximately \$70.9 million. The receipt of \$20.6 million in trust proceeds arising from our recent reconciliations of the preneed funeral and cemetery trust operating and fund backlog of Alderwoods and \$14.0 million from our internal working capital improvement initiatives were essentially offset by other working capital declines. These declines included \$21.0 million in additional interest payments resulting from increased borrowings to finance the Alderwoods acquisition, \$11.8 million in additional cash tax payments, and \$7.9 million in endowment care funds received in the first half of 2006 for which no comparable amounts were received in 2007. After taking into account the above items, the remaining increase in cash flows from



\$173.8 million aggregate principal amount of our 7.70% Notes due 2009 in a tender offer. In addition, in April 2007, we completed a private offering of \$400.0 million aggregate principal unsecured senior notes, consisting of \$200.0 million aggregate principal amount of 6.75% Senior Notes due 2015 and \$200.0 million aggregate principal amount of 7.50% Senior Notes due 2027. See more discussion on our debt instruments in note 10 to the condensed consolidated financial statements contained in this Form 10-Q.

***Financial Assurances***

In support of our operations, we have entered into arrangements with certain surety companies whereby such companies agree to issue surety bonds on our behalf as financial assurance and/or as required by existing state and local regulations. The surety bonds are used for various business purposes; however, the majority of the surety bonds issued and outstanding have been used to support our

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preneed funeral and cemetery sales activities. The obligations underlying these surety bonds are recorded on the condensed consolidated balance sheet as *Deferred preneed funeral revenues* and *Deferred preneed cemetery revenues*. The breakdown of surety bonds between funeral and cemetery preneed arrangements, as well as surety bonds for other activities, are described below.

|   | <b>June<br/>30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|---|------------------------------|------------------------------|
|   | <b>(Dollars in millions)</b> |                              |
| Preneed funeral   | \$ 132.3                     | \$ 137.0                     |
| Preneed cemetery:   |                              |                              |
| Merchandise and services                                      | 154.7                        | 162.0                        |
| Pre-construction  | 8.7                          | 8.6                          |
| <br>Bonds supporting preneed funeral and cemetery obligations | <br>295.7                    | <br>307.6                    |
| <br>Bonds supporting preneed business permits                 | <br>5.2                      | <br>3.6                      |
| Other bonds   | 15.2                         | 12.4                         |
| <br>Total surety bonds outstanding                            | <br>\$ 316.1                 | <br>\$ 323.6                 |

When selling preneed funeral and cemetery contracts, we may post surety bonds where allowed by state law. We post the surety bonds in lieu of trusting a certain amount of funds received from the customer. The amount of the bond posted is generally determined by the total amount of the preneed contract that would otherwise be required to be trusted, in accordance with applicable state law. For the three months ended June 30, 2007 and 2006, we had \$10.2 million and \$13.9 million, respectively, of cash receipts attributable to bonded sales. For the six months ended June 30, 2007 and 2006, we had \$20.6 million and \$28.2 million, respectively, of cash receipts attributable to bonded sales. These amounts do not consider reductions associated with taxes, obtaining costs, or other costs.

Surety bond premiums are paid annually and are automatically renewable until maturity of the underlying preneed contracts, unless we are given prior notice of cancellation. Except for cemetery pre-construction bonds (which are irrevocable), the surety companies generally have the right to cancel the surety bonds at any time with appropriate notice. In the event a surety company was to cancel the surety bond, we are required to obtain replacement surety assurance from another surety company or fund a trust for an amount generally less than the posted bond amount. Management does not expect we will be required to fund material future amounts related to these surety bonds because of lack of surety capacity.

***Preneed Funeral and Cemetery Activities and Backlog of Contracts***

In addition to selling our products and services to client families at the time of need, we sell price-guaranteed preneed funeral and cemetery contracts, which provide for future funeral or cemetery services and merchandise. Since preneed funeral and cemetery services or merchandise will not be provided until some time in the future, most states and provinces require that all or a portion of the funds collected from customers on preneed funeral and cemetery contracts be paid into merchandise and service trusts until the merchandise is delivered or the service is performed. In certain situations, as described above, where permitted by state or provincial laws, we post a surety bond as financial assurance for a certain amount of the preneed funeral or cemetery contract in lieu of placing funds into trust accounts. Our backlog of funeral and cemetery contracts shown below represents the total amount of future revenues we have under contract at June 30, 2007 and December 31, 2006.

The tables below detail our North America results of preneed funeral and cemetery production and maturities, excluding insurance contracts, for the three and six months ended June 30, 2007 and 2006.

**North America**

|  | <b>Three months ended</b>    |             | <b>Six months ended</b> |             |
|--|------------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>              |             | <b>June 30,</b>         |             |
|  | <b>2007</b>                  | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
|  | <b>(Dollars in millions)</b> |             |                         |             |
| <b>Funeral:</b>                          |                              |             |                         |             |
| Preneed trust-funded (including bonded): |                              |             |                         |             |
| Sales production                         | \$ 37.3                      | \$ 30.9     | \$ 74.8                 | \$ 64.6     |
| Sales production (number of contracts)   | 8,048                        | 7,339       | 16,147                  | 15,241      |
| Maturities                               | \$ 47.3                      | \$ 40.5     | \$ 103.4                | \$ 86.9     |
| Maturities (number of contracts)         | 11,274                       | 9,618       | 25,281                  | 20,294      |
| <b>Cemetery:</b>                         |                              |             |                         |             |
| Sales production:                        |                              |             |                         |             |
| Preneed                                  | \$ 111.3                     | \$ 83.5     | \$ 203.5                | \$ 160.9    |
| Atneed                                   | 69.8                         | 55.0        | 144.6                   | 111.0       |
| Total sales production                   | 181.1                        | 138.5       | 348.1                   | 271.9       |

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|  | <b>North America</b>         |             |                         |             |
|--|------------------------------|-------------|-------------------------|-------------|
|  | <b>Three months</b>          |             | <b>Six months ended</b> |             |
|  | <b>ended</b>                 |             | <b>June 30,</b>         |             |
|  | <b>2007</b>                  | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
|  | <b>(Dollars in millions)</b> |             |                         |             |
| Sales production deferred to backlog:      |                              |             |                         |             |
| Preneed                                    | \$ 49.7                      | \$ 42.2     | \$ 91.7                 | \$ 79.7     |
| Atneed                                     | 52.4                         | 41.1        | 109.0                   | 82.7        |
| Total sales production deferred to backlog | 102.1                        | 83.3        | 200.7                   | 162.4       |
| Revenue recognized from backlog:           |                              |             |                         |             |
| Preneed                                    | \$ 38.5                      | \$ 33.0     | \$ 80.3                 | \$ 61.1     |
| Atneed                                     | 52.8                         | 40.4        | 104.9                   | 80.7        |
| Total revenue recognized from backlog      | 91.3                         | 73.4        | 185.2                   | 141.8       |

*Insurance-Funded Preneed Funeral Contracts:* Where permitted by state or provincial law, customers may arrange their preneed funeral contract by purchasing a life insurance or annuity policy from third-party insurance companies, for which we earn a commission as general sales agent for the insurance company. The policy amount of the insurance contract between the customer and the third-party insurance company generally equals the amount of the preneed funeral contract. We do not reflect the unfulfilled insurance-funded preneed funeral contract amounts in our condensed consolidated balance sheet.

The table below details the North America results of insurance-funded preneed funeral production and maturities for the three and six months ended June 30, 2007 and 2006, and the number of contracts associated with those transactions.

|  | <b>North America</b>         |             |                         |             |
|--|------------------------------|-------------|-------------------------|-------------|
|  | <b>Three months ended</b>    |             | <b>Six months ended</b> |             |
|  | <b>June 30,</b>              |             | <b>June 30,</b>         |             |
|  | <b>2007</b>                  | <b>2006</b> | <b>2007</b>             | <b>2006</b> |
|  | <b>(Dollars in millions)</b> |             |                         |             |
| Preneed funeral insurance-funded(1):   |                              |             |                         |             |
| Sales production                       | \$ 68.8                      | \$ 48.5     | \$ 149.5                | \$ 96.1     |
| Sales production (number of contracts) | 11,737                       | 9,094       | 26,342                  | 18,729      |
| General agency revenue                 | \$ 12.4                      | \$ 8.6      | \$ 22.6                 | \$ 16.6     |
| Maturities                             | \$ 61.7                      | \$ 46.0     | \$ 129.6                | \$ 96.0     |
| Maturities (number of contracts)       | 12,236                       | 9,549       | 28,060                  | 20,189      |

(1) Amounts are not included in the condensed

consolidated  
balance sheet.

*North America Backlog of Preneed Funeral and Cemetery Contracts:* The following table reflects our North America backlog of trust-funded deferred preneed funeral and cemetery contract revenues including amounts related to *Non-controlling interest in funeral and cemetery trusts* at June 30, 2007 and December 31, 2006. Additionally, the table reflects our North America backlog of unfulfilled insurance-funded contracts (which is not included in our condensed consolidated balance sheet) at June 30, 2007 and December 31, 2006. The backlog amounts presented are reduced by an amount that we believe will cancel before maturity based on historical experience.

The table also reflects our North America preneed funeral and cemetery receivables and trust investments (market and cost bases) associated with the backlog of deferred preneed funeral and cemetery contract revenues, net of the estimated cancellation allowance. We believe that the table below is meaningful because it sets forth the aggregate amount of future revenues we expect to recognize as a result of preneed sales, as well as the amount of assets associated with those revenues. Because the future revenues exceed the asset amounts, future revenues will exceed the cash distributions actually received from the associated trusts.

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|  | <b>North America</b>         |                |                          |                |
|--|------------------------------|----------------|--------------------------|----------------|
|  | <b>June 30, 2007</b>         |                | <b>December 31, 2006</b> |                |
|  | <b>Market</b>                | <b>Cost</b>    | <b>Market</b>            | <b>Cost</b>    |
|  | <b>(Dollars in billions)</b> |                |                          |                |
| Backlog of trust-funded deferred preneed funeral revenues  | \$ 1.65                      | \$ 1.60        | \$ 1.66                  | \$ 1.62        |
| Backlog of insurance-funded preneed funeral revenues   | \$ 2.97                      | \$ 2.97        | \$ 2.98                  | \$ 2.98        |
| <b>Total backlog of preneed funeral revenues</b>   | <b>\$ 4.62</b>               | <b>\$ 4.57</b> | <b>\$ 4.64</b>           | <b>\$ 4.60</b> |
| Assets associated with backlog of trust-funded deferred preneed funeral revenues, net of estimated allowance for cancellation      | \$ 1.42                      | \$ 1.38        | \$ 1.45                  | \$ 1.41        |
| Insurance policies associated with insurance-funded deferred preneed funeral revenues, net of estimated allowance for cancellation | \$ 2.97                      | \$ 2.97        | \$ 2.98                  | \$ 2.98        |
| <b>Total assets associated with backlog of preneed funeral revenues</b>  | <b>\$ 4.39</b>               | <b>\$ 4.35</b> | <b>\$ 4.43</b>           | <b>\$ 4.39</b> |
| Backlog of deferred cemetery revenues  | \$ 1.88                      | \$ 1.79        | \$ 1.85                  | \$ 1.78        |
| Assets associated with backlog of deferred cemetery revenues, net of estimated allowance for cancellation                          | \$ 1.38                      | \$ 1.30        | \$ 1.36                  | \$ 1.30        |

The market value of funeral and cemetery trust investments was based primarily on quoted market prices at June 30, 2007 and December 31, 2006. The difference between the backlog and asset amounts represents the contracts for which we have posted surety bonds as financial assurance in lieu of trusting, the amounts collected from customers that were not required to be deposited into trust, and allowable cash distributions from trust assets. The table also reflects the amounts expected to be received from insurance companies through the assignment of policy proceeds related to insurance-funded funeral contracts.

**Results of Operations Three Months Ended June 30, 2007 and 2006****Management Summary**

Key highlights in the second quarter of 2007 were as follows:

a 2.0% increase in consolidated North America average revenue per funeral service compared to the second quarter of 2006;

North America funeral services performed increased 18,106, or 32.1%, in the second quarter of 2007 compared to the second quarter of 2006 as a result of locations acquired in the Alderwoods transaction; and

Impacted by divestitures and \$7.9 million of endowment care income recognized in 2006, our comparable cemetery gross margin percentage of 19.6% was down from the 21.1% recognized in the second quarter of 2006.

**Results of Operations**

In the second quarter of 2007, we reported net income of \$15.1 million (\$.05 per diluted share) compared to net income in the second quarter of 2006 of \$25.5 million (\$.09 per diluted share). These results were impacted by certain items that decreased earnings, including:

net after-tax losses on asset sales of \$9.7 million and \$3.0 million in the second quarter of 2007 and 2006, respectively;

after-tax losses from the early extinguishment of debt of \$6.9 million in the second quarter of 2007; and

after-tax one-time transition and other expenses related to our recent Alderwoods acquisition of \$2.8 million in the second quarter of 2007.

Certain items that increased earnings included:

after-tax earnings from discontinued operations of \$2.2 million in the second quarter of 2007, and \$0.1 million in the second quarter of 2006.

**Table of Contents****Consolidated Versus Comparable Results**

The table below reconciles our consolidated GAAP results to our comparable, or same store, results for the three months ended June 30, 2007 and 2006. We define comparable operations (or same store operations) as those funeral and cemetery locations that were owned for the entire period beginning January 1, 2006 and ending June 30, 2007. The following tables present operating results for funeral and cemetery locations that were owned by us during this period. As implied by our definition of comparable operations, these results specifically exclude any impact from the Alderwoods acquisition.

| <b>Three months ended June 30, 2007</b> | <b>Consolidated</b> | <b>Less:<br/>Activity<br/>Associated<br/>with<br/>Acquisition/<br/>New<br/>Construction</b> | <b>Less:<br/>Activity<br/>Associated<br/>with<br/>Dispositions</b> | <b>Comparable</b> |
|---|---------------------|---|--|-------------------|
|   |                     | <b>(Dollars in millions)</b>  |  |                   |
| North America                           |                     |   |  |                   |
| Funeral revenue                         | \$ 374.2            | \$ 102.5  | \$ 5.8   | \$ 265.9          |
| Cemetery revenue                        | 189.7               | 41.6  | 2.0  | 146.1             |
|   | 563.9               | 144.1   | 7.8  | 412.0             |
| Germany                                 |                     |   |  |                   |
| Funeral revenue                         | 1.6                 |   |  | 1.6               |
| Total revenues                          | \$ 565.5            | \$ 144.1  | \$ 7.8   | \$ 413.6          |
| North America                           |                     |   |  |                   |
| Funeral gross profits                   | \$ 70.7             | \$ 20.2   | \$ (3.3)   | \$ 53.8           |
| Cemetery gross profits                  | 32.8                | 4.6   | (0.5)  | 28.7              |
|   | 103.5               | 24.8  | (3.8)  | 82.5              |
| Germany                                 |                     |   |  |                   |
| Funeral gross profits                   | (0.1)               |   |  | (0.1)             |
| Total gross profits                     | \$ 103.4            | \$ 24.8   | \$ (3.8)   | \$ 82.4           |

| <b>Three months ended June 30, 2006</b> | <b>Consolidated</b> | <b>Less:<br/>Activity<br/>Associated<br/>with<br/>Acquisition/<br/>New<br/>Construction</b> | <b>Less:<br/>Activity<br/>Associated<br/>with<br/>Dispositions</b> | <b>Comparable</b> |
|---|---------------------|---|--|-------------------|
|   |                     | <b>(Dollars in millions)</b>  |  |                   |
| North America                           |                     |   |  |                   |
| Funeral revenue                         | \$ 278.1            | \$ 0.9  | \$ 14.0  | \$ 263.2          |
| Cemetery revenue                        | 151.7               | 0.6   | 5.9  | 145.2             |

|                        |          |    |     |    |      |    |       |
|------------------------|----------|----|-----|----|------|----|-------|
|                        | 429.8    |    | 1.5 |    | 19.9 |    | 408.4 |
| Germany                |          |    |     |    |      |    |       |
| Funeral revenue        | 1.6      |    |     |    |      |    | 1.6   |
| Total revenues         | \$ 431.4 | \$ | 1.5 | \$ | 19.9 | \$ | 410.0 |
| North America          |          |    |     |    |      |    |       |
| Funeral gross profits  | \$ 53.3  | \$ | 0.1 | \$ | 1.5  | \$ | 51.7  |
| Cemetery gross profits | 30.7     |    | 0.1 |    |      |    | 30.6  |
|                        | 84.0     |    | 0.2 |    | 1.5  |    | 82.3  |
| Germany                |          |    |     |    |      |    |       |
| Funeral gross profits  | 0.2      |    |     |    |      |    | 0.2   |
| Total gross profits    | \$ 84.2  | \$ | 0.2 | \$ | 1.5  | \$ | 82.5  |

The following table provides the data necessary to calculate our consolidated average revenue per funeral service in North America for the three months ended June 30, 2007 and 2006. We calculate average revenue per funeral service by dividing consolidated North America funeral revenue, excluding General Agency (GA) revenues and revenues from our Kenyon subsidiary, by the number of funeral services performed in North America during the period.

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|   | <b>Three months ended June 30,</b>                                       |              |
|---|--|--------------|
|   | <b>2007</b>  | <b>2006</b>  |
|   | <b>(Dollars in millions, except average revenue per funeral service)</b> |              |
| North America funeral revenue                     | \$ 374.2   | \$ 278.1     |
| Less: GA revenues                                 | 12.4   | 10.2         |
| Kenyon revenues                                   | 1.6  | 0.7          |
| <br>Adjusted North America funeral revenue        | <br>\$ 360.2   | <br>\$ 267.2 |
| <br>North America funeral services performed      | <br>74,585   | <br>56,479   |
| North America average revenue per funeral service | \$ 4,830   | \$ 4,733     |

The following table provides the data necessary to calculate our comparable average revenue per funeral service in North America for the three months ended June 30, 2007 and 2006. We calculate average revenue per funeral service by dividing comparable North America funeral revenue, excluding General Agency (GA) revenues and revenues from our Kenyon subsidiary in order to avoid distorting our averages of normal funeral services revenue, by the comparable number of funeral services performed in North America during the period.

|  | <b>Three months ended June 30,</b>                                       |              |
|--|--|--------------|
|  | <b>2007</b>  | <b>2006</b>  |
|  | <b>(Dollars in millions, except average revenue per funeral service)</b> |              |
| Comparable North America funeral revenue                     | \$ 265.9   | \$ 263.2     |
| Less: GA revenues and other                                  | 10.2   | 9.8          |
| Kenyon revenues  | 1.6  | 0.7          |
| <br>Adjusted comparable North America funeral revenue        | <br>\$ 254.1   | <br>\$ 252.7 |
| <br>Comparable North America funeral services performed      | <br>50,853   | <br>52,984   |
| Comparable North America average revenue per funeral service | \$ 4,997   | \$ 4,769     |

**Funeral Results***Funeral Revenue*

Consolidated revenues from funeral operations were \$375.8 million in the three months ended June 30, 2007 compared to \$279.7 million in the same period of 2006. The increase is primarily a result of the addition of Alderwoods operations which contributed \$101.6 million in funeral revenues in the second quarter of 2007. Alderwoods average revenue per funeral service for the second quarter 2007 was consistent with our expectations and Alderwoods funeral case volume was approximately 3% below our expectations. In addition, we divested locations which contributed an incremental \$8.2 million of revenue in the second quarter of 2006. Our comparable North America funeral revenues were up \$2.7 million, or 1.0% compared to the second quarter of 2006.

*Funeral Services Volume*

Our consolidated funeral services volume increased 18,106, or 32.1%, in the second quarter of 2007 compared to the same period in 2006. This increase includes 23,065 funeral services performed by locations acquired in the Alderwoods transaction. This increase was partially offset by a decrease from divested locations of 2,828 funeral services. Additionally, our comparable funeral services performed decreased 2,131, or 4.0%, which we attribute to certain local business decisions to exit unprofitable business relationships, primarily related to low-priced direct cremation activities, and a decrease in the number of deaths in the markets in which we operate in the second quarter

of 2007. The local business decisions mentioned above were made based on our customer segmentation strategy, which focuses on more profitable opportunities with certain customer segments. We will continue to evaluate existing relationships and may ultimately choose to exit other customer segments as we continue to employ our strategy. Our comparable cremation rate of 41.8% in the three months ended June 30, 2007 was consistent with the 41.7% rate for the same period in 2006. We have seen a stabilization in our cremation rate despite the continued increase in cremation generally in the markets where we compete, reflecting the impact of our decision to exit unprofitable immediate cremation activities.

*Average Revenue Per Funeral*

Our consolidated average revenue per funeral service increased \$97, or 2.0%, in the three months ended June 30, 2007 over the same period of 2006. Our comparable average revenue per funeral service (which excludes the Alderwoods locations) increased 4.8% or \$228 per funeral service reflecting the continued benefits from our strategic pricing initiative. Pursuant to this strategy, we have realigned our pricing focus away from our products to our service offerings, reflecting our competitive advantage and concentrating

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on services which our customers believe add the most value. This strategy has resulted in a decline in highly discounted, low-service cremation funeral services. These initiatives, although reducing our funeral services volume, have generated improvements in average revenue per funeral service. Our strategic pricing initiative was commenced at a limited number of former Alderwoods locations in the first half of 2007 and will continue to expand to other former Alderwoods locations throughout the remainder of 2007. We expect our average revenue per funeral service to continue to improve as we continue to expand this initiative.

*Funeral Gross Profit*

Consolidated funeral gross profit increased \$17.1 million in the second quarter of 2007 compared to the second quarter of 2006 primarily due to gross profit contributed from former Alderwoods operations. The consolidated gross margin percentage decreased to 18.8% from 19.1% due primarily to Alderwoods operations which historically have had lower gross profit margins, partially offset by synergies achieved in the Alderwoods transaction and cost improvements in our infrastructure. In addition, we divested locations which contributed an incremental \$4.8 million of gross profit in the second quarter of 2006 compared to the second quarter of 2007. Gross profit from our comparable North America funeral locations increased \$2.1 million primarily due to our strategic pricing initiative and more centralization and standardization in our organization.

**Cemetery Results***Cemetery Revenue*

Consolidated revenues from our cemetery operations increased \$38.0 million, or 25.0% in the second quarter of 2007 compared to the second quarter of 2006, reflecting a \$41.0 million revenue contribution from operations acquired from Alderwoods. This increase was partially offset by a \$3.9 million decline in revenue from divested locations. Our comparable cemetery revenues increased \$0.9 million in the second quarter 2007 compared to the same period of 2006, as increased preneed production in the second quarter of 2007 was partially offset by the receipt and recognition of \$7.9 million of endowment care income in the second quarter of 2006 as a result of the resolution of disputes over ownership rights to the funds.

*Cemetery Gross Profits*

Consolidated cemetery gross profit increased \$2.1 million or 6.8% in the second quarter of 2007 compared to the second quarter of 2006 reflecting the addition of gross profit from former Alderwoods locations of \$4.5 million. We also divested locations with incremental gross profits in 2007 compared to 2006 of \$0.5 million. Our comparable cemetery gross margins decreased \$1.9 million in the second quarter of 2007 compared to the second quarter of 2006 and our comparable cemetery gross margin percentage decreased to 19.6% compared to 21.1% in the same period of 2006. This was due to the revenue growth in 2007 being offset by the receipt and recognition of \$7.9 million in endowment care income described above in the second quarter of 2006. We estimate that this income positively impacted our comparable cemetery gross margin percentage for the second quarter of 2006 by approximately 450 basis points.

**Other Financial Statement Items***General and Administrative Expenses*

General and administrative expenses were \$30.3 million in the second quarter of 2007 compared to \$20.9 million in the second quarter of 2006. General and administrative costs increased \$9.4 million primarily due to \$5.6 million of one-time transition expenses, including severance, related to the acquisition of Alderwoods. Additionally, salary expense increased \$1.9 million as a result of Alderwoods corporate expenses that are expected to wind down throughout 2007.

*Gains (Losses) on Dispositions and Impairment Charges, Net*

In the second quarter of 2007, we recognized a \$9.7 million net pretax gain on asset divestitures. This gain was primarily associated with the disposition of underperforming funeral and cemetery businesses in the United States and Canada and gains on dispositions of real estate.

In the second quarter of 2006, we recognized a \$2.9 million net pretax loss from impairments and asset divestitures primarily associated with underperforming funeral and cemetery businesses in the United States and Canada.

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*Interest Expense*

Interest expense increased to \$36.2 million in the second quarter of 2007, compared to \$26.6 million in the second quarter of 2006. The increase of \$9.6 million in interest expense resulted from increased borrowings to finance the Alderwoods acquisition in the fourth quarter of 2006.

*Interest Income*

Interest income of \$2.5 million in the second quarter of 2007 represents a \$4.3 million decrease from the second quarter of 2006, as expected due to decreases in our average cash balance.

*Loss on Early Extinguishment of Debt*

In the second quarter of 2007, we purchased \$149.8 million aggregate principal amount of our 6.50% Notes due 2008 and \$173.8 million aggregate principal amount of our 7.70% Notes due 2009 in a tender offer. As a result of this transaction, we recognized a loss of \$12.1 million, which represents the write-off of unamortized deferred loan costs of \$0.4 million, a \$1.0 million loss on a related interest rate hedge, and \$10.7 million in premiums paid to extinguish the debt.

*Equity in Earnings of Unconsolidated Subsidiaries*

Equity income from our equity investment in operations in France was \$5.6 million for the second quarter of 2007 and \$0.1 million for the second quarter of 2006. The increase was driven by lower interest expense as a result of restructuring of capital and debt instruments in 2006.

*Other (Expense) Income, Net*

Other (expense) income, net was a \$0.7 million expense in the second quarter of 2007, compared to \$0.1 million in income in the second quarter of 2006. Key components of other (expense) income, net for the periods presented are as follows:

Surety bond premium costs were \$0.9 million in the second quarter of 2007 and \$1.0 million in the second quarter of 2006.

The remaining income of \$0.2 million in the second quarter of 2007 and \$1.1 million in the second quarter of 2006 is primarily attributable to gains related to foreign currency transactions.

*(Provision) Benefit for Income Taxes*

The consolidated effective tax rate in the second quarter of 2007 resulted in a provision of 69.2%, compared to a provision of 37.8% in the second quarter of 2006. The tax rates were negatively impacted by permanent differences between the book and tax bases of North American asset dispositions, FIN 48 interest and penalties, and increased state income taxes primarily as a result of state tax law changes.

*Weighted Average Shares*

The diluted weighted average number of shares outstanding was 296.1 million in the second quarter of 2007, compared to 297.5 million in the second quarter of 2006, reflecting our share repurchase program.

**Results of Operations Six Months Ended June 30, 2007 and 2006**

***Management Summary***

Key highlights in the first half of 2007 were as follows:

an improvement in first half 2007 gross margin percentage to 20.8% from 19.8% in the first half of 2006;

a 2.8% increase in consolidated North America average revenue per funeral service compared to the first half of 2006;

North America funeral services performed increased 40,932, or 34.2%, in the first half of 2007 compared to the first half of 2006 as a result of locations acquired in the Alderwoods transaction; and

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Comparable cremation rates were 41.7% in the first half of 2007 and 41.9% in the first half of 2006 reflecting our strategic pricing initiative and improved discounting policies, which have resulted in a decline in highly-discounted, low-service cremation funeral services.

***Results of Operations***

In the first half of 2007, we reported net income of \$52.8 million (\$.18 per diluted share) compared to net income in the first half of 2006 of \$52.4 million (\$.18 per diluted share). These results were impacted by certain items that decreased earnings, including:

net after-tax losses on asset sales of \$18.3 million and \$6.7 million in the first half of 2007 and 2006, respectively;

after-tax losses from the early extinguishment of debt of \$8.4 million in the first half of 2007; and

after-tax one-time transition and other expenses related to our recent Alderwoods acquisition of \$9.8 million in the first half of 2007.

Certain items that increased earnings included:

after-tax earnings from discontinued operations of \$5.1 million in the first half of 2007, and \$0.2 million in the first half of 2006.

**Table of Contents****Consolidated Versus Comparable Results**

The table below reconciles our consolidated GAAP results to our comparable, or same store, results for the six months ended June 30, 2007 and 2006. We define comparable operations (or same store operations) as those funeral and cemetery locations that were owned for the entire period beginning January 1, 2006 and ending June 30, 2007. The following tables present operating results for funeral and cemetery locations that were owned by us during this period. As implied by our definition of comparable operations, these results specifically exclude any impact from the Alderwoods acquisition.

| Six months ended June 30, 2007 | Consolidated | Less:<br>Activity<br>Associated<br>with<br>Acquisition/<br>New |  | Comparable |
|--------------------------------|--------------|--|--|------------|
|                                |              | Construction   | Less:<br>Activity<br>Associated<br>with<br>Dispositions<br>(Dollars in millions) |            |
| North America                  |              |  |  |            |
| Funeral revenue                | \$ 795.6     | \$ 218.3   | \$ 25.3  | \$ 552.0   |
| Cemetery revenue               | 374.3        | 91.2   | 6.9  | 276.2      |
|                                | 1,169.9      | 309.5  | 32.2   | 828.2      |
| Germany                        |              |  |  |            |
| Funeral revenue                | 3.1          |  |  | 3.1        |
| Total revenues                 | \$ 1,173.0   | \$ 309.5   | \$ 32.2  | \$ 831.3   |
| North America                  |              |  |  |            |
| Funeral gross profits          | \$ 172.9     | \$ 50.6  | \$ 1.3   | \$ 121.0   |
| Cemetery gross profits         | 71.6         | 18.9   | (0.7)  | 53.4       |
|                                | 244.5        | 69.5   | 0.6  | 174.4      |
| Germany                        |              |  |  |            |
| Funeral gross profits          |              |  |  |            |
| Total gross profits            | \$ 244.5     | \$ 69.5  | \$ 0.6   | \$ 174.4   |
|                                |              |  |  |            |
| Six months ended June 30, 2006 | Consolidated | Less:<br>Activity<br>Associated<br>with<br>Acquisition/<br>New |  | Comparable |
|                                |              | Construction   | Less:<br>Activity<br>Associated<br>with<br>Dispositions<br>(Dollars in millions) |            |
| North America                  |              |  |  |            |
| Funeral revenue                | \$ 579.7     | \$ 1.2   | \$ 30.4  | \$ 548.1   |
| Cemetery revenue               | 290.5        | 0.7  | 12.1   | 277.7      |

|                        |          |    |     |    |       |    |       |
|------------------------|----------|----|-----|----|-------|----|-------|
|                        | 870.2    |    | 1.9 |    | 42.5  |    | 825.8 |
| Germany                |          |    |     |    |       |    |       |
| Funeral revenue        | 3.2      |    |     |    |       |    | 3.2   |
| Total revenues         | \$ 873.4 | \$ | 1.9 | \$ | 42.5  | \$ | 829.0 |
| North America          |          |    |     |    |       |    |       |
| Funeral gross profits  | \$ 119.6 | \$ | 0.1 | \$ | 3.8   | \$ | 115.7 |
| Cemetery gross profits | 52.9     |    | 0.1 |    | (1.3) |    | 54.1  |
|                        | 172.5    |    | 0.2 |    | 2.5   |    | 169.8 |
| Germany                |          |    |     |    |       |    |       |
| Funeral gross profits  | 0.4      |    |     |    |       |    | 0.4   |
| Total gross profits    | \$ 172.9 | \$ | 0.2 | \$ | 2.5   | \$ | 170.2 |

The following table provides the data necessary to calculate our consolidated average revenue per funeral service in North America for the six months ended June 30, 2007 and 2006. We calculate average revenue per funeral service by dividing consolidated North America funeral revenue, excluding General Agency (GA) revenues and revenues from our Kenyon subsidiary, by the number of funeral services performed in North America during the period.

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|   | <b>Six months ended June 30,<br/>2007</b>  |             | <b>2006</b> |             |
|---|--|-------------|-------------|-------------|
|   | <b>(Dollars in millions, except<br/>average<br/>revenue per funeral service)</b> |             |             |             |
| North America funeral revenue                     | \$   | 795.6       | \$          | 579.7       |
| Less: GA revenues                                 |  | 22.6        |             | 19.7        |
| Kenyon revenues                                   |  | 2.8         |             | 1.9         |
| <br>Adjusted North America funeral revenue        | <br>\$   | <br>770.2   | <br>\$      | <br>558.1   |
| <br>North America funeral services performed      |  | <br>160,672 |             | <br>119,740 |
| North America average revenue per funeral service | \$   | 4,793       | \$          | 4,661       |

The following table provides the data necessary to calculate our comparable average revenue per funeral service in North America for the six months ended June 30, 2007 and 2006. We calculate average revenue per funeral service by dividing comparable North America funeral revenue, excluding General Agency (GA) revenues and revenues from our Kenyon subsidiary in order to avoid distorting our averages of normal funeral services revenue, by the comparable number of funeral services performed in North America during the period.

|  | <b>Six months ended June 30,<br/>2007</b>  |             | <b>2006</b> |             |
|--|--|-------------|-------------|-------------|
|  | <b>(Dollars in millions, except<br/>average<br/>revenue per funeral service)</b> |             |             |             |
| Comparable North America funeral revenue                     | \$   | 552.0       | \$          | 548.1       |
| Less: GA revenues and other                                  |  | 19.8        |             | 18.9        |
| Kenyon revenues  |  | 2.8         |             | 1.9         |
| <br>Adjusted comparable North America funeral revenue        | <br>\$   | <br>529.4   | <br>\$      | <br>527.3   |
| <br>Comparable North America funeral services performed      |  | <br>106,931 |             | <br>112,228 |
| Comparable North America average revenue per funeral service | \$   | 4,951       | \$          | 4,699       |

**Funeral Results***Funeral Revenue*

Consolidated revenues from funeral operations were \$798.7 million in the six months ended June 30, 2007 compared to \$582.9 million in the same period of 2006. The increase is primarily a result of the addition of Alderwoods operations which contributed \$217.1 million in funeral revenues in the first half of 2007. Alderwoods average revenue per funeral service for the first half of 2007 was consistent with our expectations and Alderwoods funeral case volume was approximately 3% below our expectations, which we believe is generally consistent with death trends in North America in the first half of 2007. In addition, we divested locations which contributed \$5.1 million of incremental revenue in the first half of 2006. Our comparable North America funeral revenues were up \$3.9 million, or 0.7% compared to the first half of 2006.

*Funeral Services Volume*

Our consolidated funeral services volume increased 40,932, or 34.2%, in the first half of 2007 compared to the same period in 2006. This increase includes 51,659 funeral services performed by locations acquired in the Alderwoods transaction. This increase was partially offset by a decrease from divested locations of 5,430 funeral services. Additionally, our comparable funeral services performed decreased 5,297, or 4.7%, which we attribute to certain local business decisions to exit unprofitable business relationships, primarily related to low-priced direct

cremation activities, and a decrease in the number of deaths in our markets in the first half of 2007. The local business decisions mentioned above were made based on our customer segmentation strategy, which focuses on more profitable opportunities with certain customer segments. We will continue to evaluate existing relationships and may ultimately choose to exit other markets as we continue to employ our strategy. Our comparable cremation rate of 41.7% in the six months ended June 30, 2007 was down compared to 41.9% for the same period in 2006. We have seen a stabilization in our cremation rate despite the continued increase in cremation generally in the markets where we compete, reflecting the impact of our decision to exit unprofitable immediate cremation activities.

*Average Revenue Per Funeral*

Our consolidated average revenue per funeral service increased \$132, or 2.8%, in the six months ended June 30, 2007 over the same period of 2006. Our comparable average revenue per funeral service (which excludes the Alderwoods locations) increased 5.4% or \$252 per funeral service reflecting the continued benefits from our strategic pricing initiative at legacy locations. Pursuant to this

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strategy, we have realigned our pricing focus away from our products to our service offerings, reflecting our competitive advantage and concentration on those services, which our customers believe add the most value. This strategy has resulted in a decline in highly discounted, low-service cremation funeral services. These initiatives, although reducing our funeral services volume, have generated improvements in average revenue per funeral service. Our strategic pricing initiative was commenced at a limited number of former Alderwoods locations in the first half of 2007 and will continue to expand to other former Alderwoods locations throughout the remainder of 2007. We expect our average revenue per funeral service to continue to improve as we continue to expand this initiative.

***Funeral Gross Profit***

Consolidated funeral gross profit increased \$52.9 million in the first half of 2007 compared to the first half of 2006 primarily due to gross profit contributed from former Alderwoods operations of \$50.6 million. The consolidated gross margin percentage increased to 21.6% from 20.6% due primarily to synergies achieved in the Alderwoods transaction and cost improvements in our infrastructure partially offset by a decrease in funeral gross profit contributed from locations that were divested in the second quarter of 2007. We divested locations which contributed an incremental \$2.5 million of gross profit in the first half of 2006. Gross profit from our comparable North America funeral locations increased \$5.3 million primarily due to more centralization and standardization in our organization. Comparable North America funeral gross margin percentage increased to 21.9% in the first half of 2007 compared to 21.1% in the same period of 2006.

***Cemetery Results******Cemetery Revenue***

Consolidated revenues from our cemetery operations increased \$83.8 million, or 28.8% in the first half of 2007 compared to the first half of 2006, reflecting a \$90.5 million increase from operations acquired from Alderwoods. Consolidated cemetery property revenue increased \$46.4 million primarily due to operations acquired from Alderwoods. This includes \$18.0 million related to the Rose Hills cemetery as several large construction projects were completed during the first quarter. This increase was partially offset by a \$5.2 million decline in revenue from divested locations. Our comparable cemetery revenues declined \$1.5 million in the first half of 2007 compared to the same period of 2006, as increased preneed production was more than offset by the receipt and recognition of \$7.9 million of previously disputed endowment care income in the second quarter of 2006.

***Cemetery Gross Profits***

Consolidated cemetery gross profit increased \$18.7 million or 35.3% in the first half of 2007 compared to the first half of 2006 reflecting the addition of gross profit from former Alderwoods operations of \$18.8 million. Consolidated cemetery gross margin percentages increased to 19.1% in the first half of 2007 from 18.2% in the same period of 2006. We also divested locations with incremental gross profit in 2007 compared to 2006 of \$0.6 million. Our comparable cemetery gross margins decreased \$0.7 million in the first half of 2007 compared to the first half of 2006 as increases in revenue were more than offset by the receipt and recognition of \$7.9 million of previously disputed endowment care income in the second quarter of 2006. We estimate that this income positively impacted our comparable cemetery gross margin percentage for the first half of 2006 by approximately 240 basis points. Comparable North America cemetery margin percentage was 19.3% in the first half of 2007 compared to 19.5% in the first half of 2006.

***Other Financial Statement Items******General and Administrative Expenses***

General and administrative expenses were \$65.7 million in the first half of 2007 compared to \$42.9 million in the first half of 2006. General and administrative costs increased \$22.8 million primarily due to \$16.9 million of one-time transition expenses, including severance, related to the acquisition of Alderwoods. Additionally, salary expense increased \$4.8 million as a result of Alderwoods corporate expenses that are expected to wind down throughout 2007.

***Gains (Losses) on Dispositions and Impairment Charges, Net***

In the first half of 2007, we recognized a \$2.1 million net pretax gain on asset divestitures. This gain was primarily associated with the disposition of underperforming funeral and cemetery businesses in the United States and Canada, and gains on dispositions of real estate.

In the first half of 2006, we recognized a \$7.4 million net pretax loss from impairments and asset divestitures primarily associated with underperforming funeral and cemetery businesses in the United States and Canada.

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### *Interest Expense*

Interest expense increased to \$73.8 million in the first half of 2007, compared to \$53.3 million in the first half of 2006. The increase of \$20.5 million in interest expense resulted from increased borrowings to finance the Alderwoods acquisition in the fourth quarter of 2006.

### *Interest Income*

Interest income of \$4.1 million in the first half of 2007 represents a \$8.7 million decrease from the first half of 2006, as expected due to decreases in our average cash balance.

### *Loss on Early Extinguishment of Debt*

During 2007, we repaid \$100.0 million of our term loan and purchased \$149.8 million aggregate principal amount of our 6.50% Notes due 2008 and \$173.8 million aggregate principal amount of our 7.70% Notes due 2009 in a tender offer. As a result of these transactions, we recognized a loss of \$14.5 million, which represents the write-off of unamortized deferred loan costs of \$2.1 million, a \$1.0 million loss on a related interest rate hedge, and \$11.4 million in premiums paid to extinguish the debt.

### *Equity in Earnings of Unconsolidated Subsidiaries*

Equity income from our equity investment in operations in France was \$6.3 million for the first half of 2007 and \$0.1 million for the first half of 2006. The increase was driven by lower interest expense as a result of restructuring of capital and debt instruments in 2006.

### *Other (Expense) Income, Net*

Other (expense) income, net was a \$2.9 million expense in the first half of 2007, compared to \$1.1 million in income in the first half of 2006. Key components of other (expense) income, net for the periods presented are as follows:

Surety bond premium costs were \$1.8 million in the first half of 2007 and \$2.0 million in the first half of 2006.

The first half of 2007 includes \$1.3 million of unfavorable adjustments to our notes receivable allowance compared to \$2.0 million of favorable adjustments in the first half of 2006.

The remaining income of \$0.2 million in the first half of 2007 and \$1.1 million in the first half of 2006 is primarily attributable to gains related to foreign currency transactions.

### *(Provision) Benefit for Income Taxes*

The consolidated effective tax rate in the first half of 2007 resulted in a provision of 52.4%, compared to a provision of 37.3% in the first half of 2006. The tax rates were negatively impacted by permanent differences between the book and tax bases of North American asset dispositions, FIN 48 interest and penalties, and increased state income taxes primarily as a result of state tax law changes.

### *Weighted Average Shares*

The diluted weighted average number of shares outstanding was 297.5 million in the first half of 2007, compared to 297.8 million in the first half of 2006, reflecting our share repurchase program.

## **Critical Accounting Policies**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006. No significant changes to our accounting policies have occurred subsequent to December 31, 2006, except as described below within ***Recent Accounting Pronouncements and Accounting Changes***.

### ***Recent Accounting Pronouncements and Accounting Changes***

For discussion of recent accounting pronouncements and accounting changes, see Part I, Item 1. Financial Statements, Note 3.

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**Cautionary Statement on Forward-Looking Statements**

The statements in this Form 10-Q that are not historical facts are forward-looking statements made in reliance on the safe harbor protections provided under the Private Securities Litigation Reform Act of 1995. These statements may be accompanied by words such as believe, estimate, project, expect, anticipate, or predict, that convey the uncertainty of future events or outcomes. These statements are based on assumptions that we believe are reasonable; however, many important factors could cause our actual results in the future to differ materially from the forward-looking statements made herein and in any other documents or oral presentations made by us or on our behalf. Important factors, which could cause actual results to differ materially from those in forward-looking statements include, among others, the following:

Changes in general economic conditions, both domestically and internationally, impacting financial markets (e.g., marketable security values, as well as currency and interest rate fluctuations) that could negatively affect us, particularly, but not limited to, levels of trust fund income, interest expense, pension expense, and negative currency translation effects.

Our ability to successfully integrate Alderwoods or to fully realize the anticipated benefits of the acquisition.

The outcomes of pending lawsuits, proceedings, and claims against us and the possibility that insurance coverage is deemed not to apply to these matters or that an insurance carrier is unable to pay any covered amounts to us.

Allegations regarding compliance with laws, regulations, industry standards, and customs regarding burial procedures and practices.

The amounts payable by us with respect to our outstanding legal matters exceed our established reserves.

The outcome of a pending Internal Revenue Service audit. We maintain accruals for tax liabilities that relate to uncertain tax matters. If these tax matters are unfavorably resolved, we will make any required payments to tax authorities. If these tax matters are favorably resolved, the accruals maintained by us will no longer be required, and these amounts will be reversed through the tax provision at the time of resolution.

Our ability to manage changes in consumer demand and/or pricing for our products and services due to several factors, such as changes in numbers of deaths, cremation rates, competitive pressures, and local economic conditions.

Changes in domestic and international political and/or regulatory environments in which we operate, including potential changes in tax, accounting, and trusting policies.

Changes in credit relationships impacting the availability of credit and the general availability of credit in the marketplace.

Our ability to successfully access surety and insurance markets at a reasonable cost.

Our ability to successfully leverage our substantial purchasing power with certain of our vendors.

The effectiveness of our internal control over financial reporting, and our ability to certify the effectiveness of the internal controls and to obtain an unqualified attestation report of our auditors regarding the effectiveness of our internal control over financial reporting.

Our credit agreement and privately placed debt securities that may prevent us from engaging in certain transactions.

Our ability to buy our common stock under our share repurchase programs which could be impacted by, among others, restrictive covenants in our bank agreements, unfavorable market conditions, the market price of our common stock, the nature of other investment opportunities presented to us from time to time, and the availability of funds necessary to continue purchasing common stock.

For further information on these and other risks and uncertainties, see our Securities and Exchange Commission filings, including our 2006 Annual Report on Form 10-K. Copies of this document as well as other SEC filings can be obtained from our website at [www.sci-corp.com](http://www.sci-corp.com). We assume no obligation to publicly update or revise any forward-looking statements made herein or any other forward-looking statements made by us, whether as a result of new information, future events or otherwise.

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

There have been no significant changes in our exposure to market risk during the most recently completed fiscal quarter.

**Item 4. Controls and Procedures**

***Disclosure Controls and Procedures***

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic Securities Exchange Act of 1934 reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Disclosure Committee and management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b). Based upon, and as of the date of this evaluation, such officers concluded that our disclosure controls and procedures were effective.

***Changes in Internal Control Over Financial Reporting***

There have been no changes in our internal control over financial reporting during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

Information regarding legal proceedings is set forth in Note 16 to the unaudited condensed consolidated financial statements in Item 1 of Part I of this Form 10-Q, which information is hereby incorporated by reference herein.

**Item 1A. Risk Factors**

There have been no material changes in our Risk Factors as set forth in Item 1A of our Form 10-K for the fiscal year ended December 31, 2006.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On April 30, 2007, we issued 324 deferred common stock equivalents, or units, pursuant to provisions regarding dividends under the Amended and Restated Director Fee Plan to four non-employee directors. On May 9, 2007, we issued 10,000 shares of common stock and deferred common stock to each of nine non-employee directors pursuant to the Amended and Restated Director Fee Plan. We did not receive any monetary consideration for the issuances. These issuances were unregistered because they did not constitute a sale within the meaning of Section 2(3) of the Securities Act of 1933, as amended.

As of June 30, 2007, the aggregate purchases pursuant to our share repurchase program totaled \$466.9 million. As of June 30, 2007, the remaining dollar value of shares that may yet be purchased under our share repurchase program was approximately \$97.1 million. Pursuant to the program, we repurchased shares of our common stock during the second quarter of 2007 as set forth in the table below.

| Period        |                | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced programs | Dollar value of shares that may yet be purchased under the programs |
|---------------|----------------|----------------------------------|------------------------------|---|---|
| April 1, 2007 | April 30, 2007 | 855,000                          | 12.10                        | 855,000   | 190,369,946   |
| May 1, 2007   | May 31, 2007   | 5,936,808                        | 12.90                        | 5,936,808   | 113,811,551   |
| June 1, 2007  | June 30, 2007  | 1,234,000                        | 13.52                        | 1,234,000   | 97,122,765  |
|               |                | 8,025,808                        |                              | 8,025,808   |   |

As of July 31, 2007, we repurchased 1,647,400 shares of common stock at an aggregate cost of \$20.9 million (average cost per share of \$12.68). In August, our Board of Directors approved an increase in our share repurchase program authorizing the investment of up to an additional \$200 million to repurchase our common stock. After these events, the remaining dollar value of shares authorized to be purchased under our share repurchase program was approximately \$276.2 million.

**Item 4. Submission of Matters to a Vote of Security Holders**

On May 9, 2007, we held our annual meeting of shareholders and elected three directors. The shares voting on the director nominees were cast as follows:

| Nominee                 | Votes for   | Abstentions or votes withheld |
|-------------------------|-------------|-------------------------------|
| Alan R. Buckwalter, III | 253,152,629 | 9,411,733                     |
| Victor L. Lund          | 253,122,934 | 9,441,428                     |
| John W. Mecom, Jr.      | 259,103,512 | 3,460,849                     |

In addition, the shareholders approved the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm for 2007. The shares voting were cast as follows:

| Votes for | Votes against | Abstentions or votes withheld | Broker non-votes |
|-----------|---------------|-------------------------------|------------------|
|-----------|---------------|-------------------------------|------------------|

259,236,508

3,116,828

211,025

0

49

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The shareholders also approved the Company's Amended 1996 Incentive Plan, as follows:

| <b>Votes for</b> | <b>Votes against</b> | <b>Abstentions or votes withheld</b> | <b>Broker non-votes</b> |
|------------------|----------------------|--------------------------------------|-------------------------|
| 176,384,814      | 50,100,176           | 498,819                              | 35,580,553              |

**Item 6. Exhibits**

- 10.1 Agreement and First Amendment to Credit Agreement, dated as of June 14, 2007, among the Company and the lenders party thereto. (Incorporated by reference to Exhibit 10.1 to Form 8-K dated June 20, 2007).
- 10.2 First Amendment to Note Purchase Agreement, dated as of June 11, 2007, among the Company and the purchasers party thereto. (Incorporated by reference to Exhibit 10.2 to Form 8-K dated June 20, 2007).
- 12.1 Ratio of earnings to fixed charges for the six months ended June 30, 2007 and 2006.
- 31.1 Certification of Thomas L. Ryan as Chief Executive Officer in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Eric D. Tanzberger as Principal Financial Officer in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Periodic Financial Reports by Thomas L. Ryan as Chief Executive Officer in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Periodic Financial Reports by Eric D. Tanzberger as Principal Financial Officer in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002.

**Undertaking**

We hereby undertake, pursuant to Regulation S-K, Item 601(b), paragraph (4) (iii), to furnish to the U.S. Securities and Exchange Commission, upon request, all constituent instruments defining the rights of holders of our long-term debt not filed herewith for the reason that the total amount of securities authorized under any of such instruments does not exceed 10 percent of our total consolidated assets.

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**SIGNATURE**

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

August 8, 2007

SERVICE CORPORATION  
INTERNATIONAL

By: /s/ Jeffrey I. Beason  
Jeffrey I. Beason  
Vice President and Corporate Controller  
(Chief Accounting Officer)

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