

SERVICE CORPORATION INTERNATIONAL

Form 10-Q

November 09, 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 September 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 November 1, 2007 was 278,672,176 (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>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Revenues	\$ 539,334	\$ 400,389	\$ 1,712,381	\$ 1,273,790
Costs and expenses	(436,814)	(327,341)	(1,365,346)	(1,027,860)
Gross profit	102,520	73,048	347,035	245,930
General and administrative expenses	(32,074)	(20,956)	(97,754)	(63,885)
Gains (losses) on dispositions and impairment charges, net	4,886	(30,750)	6,949	(38,141)
Operating income	75,332	21,342	256,230	143,904
Interest expense	(38,090)	(33,330)	(111,852)	(86,667)
Loss on early extinguishment of debt			(14,480)	
Interest income	4,254	8,259	8,324	21,022
Equity in earnings of unconsolidated subsidiaries	2,460	1,214	8,730	1,351
Other (expense) income, net	(1,049)	10,118	(3,981)	11,176
Income from continuing operations before income taxes	42,907	7,603	142,971	90,786
Provision for income taxes	(14,062)	(4,797)	(66,500)	(35,846)
Income from continuing operations	28,845	2,806	76,471	54,940
(Loss) income from discontinued operations (net of income tax provision (benefit) of \$2,223, (\$201), \$4,183 and \$(118), respectively)	(675)	559	4,459	801
Net income	\$ 28,170	\$ 3,365	\$ 80,930	\$ 55,741
Basic earnings per share:				
Income from continuing operations	\$ .10	\$ .01	\$ .26	\$ .19
Income from discontinued operations, net of tax			.02	
Net income	\$ .10	\$ .01	\$ .28	\$ .19
Diluted earnings per share:				
Income from continuing operations	\$ .10	\$ .01	\$ .26	\$ .19
Income from discontinued operations, net of tax			.01	
Net income	\$ .10	\$ .01	\$ .27	\$ .19
Basic weighted average number of shares	284,511	291,662	289,437	293,117

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Diluted weighted average number of shares	289,597	295,918	294,848	297,353
Dividends declared per share	\$ .030	\$ .025	\$ .090	\$ .075

(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>September 30, 2007</b>	<b>December 31, 2006</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 287,738	\$ 39,880
Receivables, net	104,054	107,194
Inventories	37,898	39,535
Current assets of discontinued operations		2,236
Current assets held for sale	5,404	6,330
Other	34,578	43,162
 Total current assets	 469,672	 238,337
 Preneed funeral receivables and trust investments	 1,518,187	 1,516,676
Preneed cemetery receivables and trust investments	1,465,881	1,522,584
Cemetery property, at cost	1,446,213	1,495,248
Property and equipment, net	1,577,514	1,641,353
Non-current assets of discontinued operations		371,132
Non-current assets held for sale	350,066	349,311
Goodwill	1,268,493	1,264,272
Deferred charges and other assets	396,138	436,545
Cemetery perpetual care trust investments	916,629	893,931
	\$ 9,408,793	\$ 9,729,389
 <b>Liabilities &amp; Stockholders Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 340,965	\$ 341,173
Current maturities of long-term debt	156,466	46,176
Current liabilities of discontinued operations		2,351
Current liabilities held for sale	199	419
Income taxes	45,192	17,828
 Total current liabilities	 542,822	 407,947
 Long-term debt	 1,779,830	 1,912,696
Deferred preneed funeral revenues	548,261	537,792
Deferred preneed cemetery revenues	697,120	754,193
Deferred income taxes	73,166	177,341
Non-current liabilities of discontinued operations		311,498
Non-current liabilities held for sale	270,048	239,800
Other liabilities	479,987	357,418
Non-controlling interest in funeral and cemetery trusts	2,527,809	2,548,743

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Non-controlling interest in cemetery perpetual care trusts	913,445	887,186
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Common stock, \$1 per share par value, 500,000,000 shares authorized, 280,158,739 and 293,222,114, issued and outstanding (net of 16,805,762 and 10,000 treasury shares, at par)	280,159	293,222
Capital in excess of par value	2,000,324	2,135,649
Accumulated deficit	(865,496)	(906,394)
Accumulated other comprehensive income	161,318	72,298
Total stockholders' equity	1,576,305	1,594,775
	\$ 9,408,793	\$ 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>Nine months ended</b>	
	<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 80,930	\$ 55,741
Adjustments to reconcile net income to net cash provided by operating activities:		
Net income from discontinued operations, net of tax	(4,459)	(801)
Loss on early extinguishment of debt	14,480	
Premiums paid on early extinguishment of debt	(11,368)	
Depreciation and amortization	99,308	69,601
Amortization of cemetery property	24,983	18,589
Amortization of loan costs	5,202	13,902
Provision for doubtful accounts	7,753	6,688
Provision for deferred income taxes	20,798	23,486
(Gains) losses on dispositions and impairment charges, net	(6,949)	38,141
Share-based compensation	7,898	5,487
Excess tax benefits from share-based awards	(5,159)	
Equity in earnings of unconsolidated subsidiaries	(8,730)	(1,351)
Change in assets and liabilities, net of effects from acquisitions and dispositions:		
(Increase) decrease in receivables	(7,027)	18,515
Increase in other assets	(1,418)	(19,247)
Increase (decrease) in payables and other liabilities	33,436	(7,482)
Effect of preneed funeral production and maturities:		
Decrease in preneed funeral receivables and trust investments	27,236	24,565
Increase in deferred preneed funeral revenue	41,938	2,655
Decrease in funeral non-controlling interest	(50,013)	(20,959)
Effect of cemetery production and deliveries:		
Decrease in preneed cemetery receivables and trust investments	41,811	20,904
Increase (decrease) in deferred preneed cemetery revenue	36,347	(8,930)
(Decrease) increase in cemetery non-controlling interest	(36,228)	25,079
Other	578	51
Net cash provided by operating activities from continuing operations	311,347	264,634
Net cash provided by operating activities from discontinued operations	17,279	698
Net cash provided by operating activities	328,626	265,332
<b>Cash flows from investing activities:</b>		
Capital expenditures	(113,607)	(63,199)
Proceeds from divestitures, net of cash retained and sales of property and equipment	314,255	54,766
Acquisitions	(3,308)	(14,637)
Net withdrawals of restricted funds and other	(236)	10,435
Net cash provided by (used in) investing activities from continuing operations	197,104	(12,635)
Net cash (used in) provided by investing activities from discontinued operations	(8,546)	11,328

Net cash provided by (used in) investing activities	6	188,558	(1,307)
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	<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Cash flows from financing activities:</b>		
Proceeds from long-term debt issued	398,996	
Debt issuance costs	(6,443)	
Payments of debt	(3,043)	(14,287)
Principal payments on capital leases	(22,060)	(15,968)
Early extinguishment of debt	(422,545)	
Proceeds from exercise of stock options	19,373	3,614
Purchase of Company common stock	(211,082)	(27,870)
Excess tax benefits from share-based awards	5,159	
Payments of dividends	(26,265)	(22,113)
Bank overdrafts	(829)	
Net cash used in financing activities from continuing operations	(268,739)	(76,624)
Net cash used in financing activities from discontinued operations	(2,113)	
Net cash used in financing activities	(270,852)	(76,624)
Effect of foreign currency	1,526	2,450
Net increase in cash and cash equivalents	247,858	189,851
Cash and cash equivalents at beginning of period	39,880	446,782
Cash and cash equivalents at end of period	\$ 287,738	\$ 636,633

(See notes to unaudited condensed consolidated financial statements)

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

	Outstanding shares	Common stock	Treasury stock, par value	Capital in excess of par value	Accumulated deficit	Accumulated other comprehensive income	Total
Balance at December 31, 2006	293,222	\$ 293,232	\$ (10)	\$ 2,135,649	\$ (906,394)	\$ 72,298	\$ 1,594,775
Cumulative effect of adoption of FIN 48					11,987		11,987
Net income					80,930		80,930
Dividends declared on common stock (\$0.09 per share)				(26,094)			(26,094)
Total other comprehensive income						89,020	89,020
Employee share based compensation earned				7,898			7,898
Stock option exercises and other	3,478	3,418	60	15,955			19,433
Restricted stock awards, net of forfeitures	314	314		(314)			
Tax benefit related to share-based awards				9,438			9,438
Purchase of Company stock	(16,855)		(16,855)	(142,208)	(52,019)		(211,082)
Balance at September 30, 2007	280,159	\$ 296,964	\$ (16,805)	\$ 2,000,324	\$ (865,496)	\$ 161,318	\$ 1,576,305

(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. At September 30, 2007, we also owned a minority interest in funeral operations of an entity in France, which we divested in the fourth quarter of 2007. Additionally, at September 30, 2007, we owned Kenyon International Emergency Services (Kenyon), a wholly-owned subsidiary that specializes in providing disaster management services in mass fatality incidents as well as training, planning, and crisis-communications consulting services. We divested 70% of our Kenyon investment in the fourth quarter of 2007. 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 that we sold in July 2007. The operations of this business through the date of sale are presented as discontinued operations in our condensed consolidated statement of operations.

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 third quarter of 2007, we recorded a net decrease in our liability for uncertain tax positions of approximately \$24.5 million relating to uncertain positions taken in prior years, as a result of expiring federal, state, and foreign statute of limitations, and the sale of assets. Of the \$24.5 million, \$20.9 million was recorded as an adjustment of goodwill related to uncertain tax positions acquired in our Alderwoods transaction. We also recorded a \$0.4 million increase in the liability for unrecognized tax benefits related to our recent Alderwoods transaction, which was recorded as a purchase price allocation adjustment. 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 a purchase price allocation adjustment.

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 is currently auditing tax years 2003 through 2005. Various state and foreign jurisdictions are auditing years through

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2005. It is reasonably possible that one or more of these multi-jurisdictional audits will be settled in the fourth quarter of 2007 or 2008, 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 penalties at January 1, 2007, which is included in the \$257.1 million in unrecognized tax benefits noted above. During the three and nine months ended September 30, 2007, we recognized an additional \$2.5 million and \$7.5 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 nine months ended September 30, 2007 were 32.8% and 46.5%, respectively, compared to 63.1% and 39.5% for the same periods in 2006. The lower effective tax rate for the three months ended September 30, 2007 was impacted by a net decrease in our liability for uncertain tax positions, an adjustment for tax returns filed, and state tax law changes.

The effective tax rate for the nine months ended September 30, 2007 was impacted by permanent differences between the book and tax bases of asset dispositions, state income taxes, and newly required interest and penalties accrued on existing uncertain tax positions.

**5. Alderwoods Acquisition**

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

Adjustments to fair value of deferred revenue	(30,839)
Adjustments to fair value of intangible assets	23,977
Adjustments to fair value of trust assets	19,307
Adjustments to fair value of acquired locations	(49,469)
Adjustments to deferred taxes	1,804
Other	3,302
Total adjustment to Alderwoods goodwill	\$ (31,918)

During the three and nine months ended September 30, 2007, we recorded adjustments to our acquired Alderwoods goodwill related to our ongoing verification of the contract status and fair values of preneed cemetery and funeral deferred revenues and related trust and intangible assets. In addition, during the second quarter of 2007, we adjusted the fair values of certain assets and liabilities sold during the quarter, in relation to certain Alderwoods locations mandated for divestment pursuant to our recent FTC decree. Although we previously disclosed our finalization of fair value adjustments related to the acquired Alderwoods preneed contracts as of the end of the second quarter, we now expect to conclude our remaining analysis and record any required adjustments in the fourth quarter of 2007, due to on-going work related to the preparation and review of certain Alderwoods account reconciliations.

Certain pre-acquisition contingencies primarily relating to legal matters existed at the date of the merger, and 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 fourth quarter of 2007.

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

<b>Three months ended</b>	<b>Nine months ended</b>
-----------------------------------	------------------------------

	<b>September 30, 2006</b>	<b>September 30, 2006</b>
	<b>(In thousands)</b>	
Revenues	\$571,928	\$ 1,711,799
(Loss) income from continuing operations	\$ (1,940)	\$ 45,414
Net (loss) income	\$ (1,381)	\$ 44,973
(Loss) income from continuing operations per share:		
Basic	\$ (.01)	\$ .15
Diluted	\$ (.01)	\$ .15
Net (loss) income per share:		
Basic	\$ (.01)	\$ .15
Diluted	\$ (.01)	\$ .15



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*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 \$20.7 million and \$20.1 million into and withdrew \$37.8 million and \$26.1 million from the trusts during the three months ended September 30, 2007 and 2006, respectively. We deposited \$66.1 million and \$62.0 million into and withdrew \$112.0 million and \$82.6 million from the trusts during the nine months ended September 30, 2007 and 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 September 30, 2007 and December 31, 2006 are as follows:

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
	<b>(In thousands)</b>	
Trust investments, at market	\$ 1,325,665	\$ 1,329,922
Receivables from customers	222,005	224,740
	1,547,670	1,554,662
Allowance for cancellation	(29,483)	(37,986)
Preneed funeral receivables and trust investments	\$ 1,518,187	\$ 1,516,676

The cost and market values associated with funeral trust investments at September 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 102% and 103% of the related cost basis of such investments as of September 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 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. As a result of our most recent review at September 30, 2007, we recorded no additional impairment charges. See Note 9 to the condensed consolidated financial statements for further information related to our non-controlling interest in funeral trust investments.

	<b>September 30, 2007</b>			
	<b>Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Market Value</b>
	<b>(In thousands)</b>			
Cash and cash equivalents	\$ 360,484	\$	\$	\$ 360,484
Fixed income securities:				
U.S. Treasury	90,581	1,046	(138)	91,489

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Foreign government	92,368	280	(957)	91,691
Corporate	10,136	288	(53)	10,371
Mortgage-backed	5,482	68	(15)	5,535
Insurance-backed	178,483			178,483
Asset-backed	29			29
Equity securities:				
Preferred stock	1,586	82	(8)	1,660
Common stock	289,738	18,866	(1,818)	306,786
Mutual funds:				
Equity	87,588	6,062	(422)	93,228
Fixed income	138,611	5,897	(966)	143,542
Private equity and other	70,419	3,728	(4,634)	69,513
Trust investments	\$ 1,325,505	\$ 36,317	\$ (9,011)	\$ 1,352,811
Less: Assets associated with businesses held for sale				(27,146)
				\$ 1,325,665

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

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

	<b>Market (In thousands)</b>
Due in one year or less	\$ 110,914
Due in one to five years	76,092
Due in five to ten years	92,884
Thereafter	97,708
	\$ 377,598

During the three months ended September 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$342.0 million and \$379.6 million, respectively. These sale transactions resulted in \$54.9 million and \$10.7 million of realized gains and realized losses, respectively, for the three months ended September 30, 2007. During the three months ended September 30, 2006, purchases and sales of available-for-sale securities included in trust investments were \$171.1 million and \$197.5 million, respectively. These sale transactions resulted in \$15.3 million and \$13.7 million of realized gains and realized losses, respectively for the three months ended September 30, 2006.

During the nine months ended September 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$653.9 million and \$575.1 million, respectively. These sale transactions resulted in \$87.7 million and \$22.8 million of realized gains and realized losses, respectively, for the nine months ended September 30, 2007. During the nine months ended September 30, 2006, purchases and sales of available-for-sale securities included in trust investments were \$325.8 million and \$357.2 million, respectively. These sale transactions resulted in \$49.1 million and \$25.5 million of realized gains and realized losses, respectively for the nine months ended September 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 funeral contract. Only the amount we are entitled to retain is recognized when a contract is cancelled. Recognized earnings (realized and unrealized) related to these trust investments were \$11.2 million and \$7.6 million for the three months ended September 30, 2007 and 2006, respectively. Recognized earnings (realized and unrealized) related to these trust investments were \$33.3 million and \$26.6 million for the nine months ended September 30, 2007 and 2006, respectively.

**Table of Contents****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 \$30.1 million and \$27.4 million into and withdrew \$40.1 million and \$27.5 million from the trusts during the three months ended September 30, 2007 and 2006, respectively. We deposited \$89.3 million and \$91.7 million into and withdrew \$121.3 million and \$68.7 million from the trusts during the nine months ended September 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 September 30, 2007 and December 31, 2006 are as follows:

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
	<b>(In thousands)</b>	
Trust investments, at market	\$ 1,217,329	\$ 1,236,446
Receivables from customers	353,066	384,428
Unearned finance charges	(49,180)	(54,704)
	1,521,215	1,566,170
Allowance for cancellation	(55,334)	(43,586)
Preneed cemetery receivables and trust investments	\$ 1,465,881	\$ 1,522,584

The cost and market values associated with the cemetery merchandise and service trust investments at September 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 105% and 106% of the related cost basis of such investments as of September 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 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. As a result of our most recent review at September 30, 2007, we recorded no additional impairment charges. See Note 9 to the condensed consolidated financial statements for further information related to our non-controlling interest in cemetery trust investments.

	<b>September 30, 2007</b>		<b>Fair Market Value</b>
<b>Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	
	<b>(In thousands)</b>		

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Cash and cash equivalents	\$ 431,694	\$	\$	\$ 431,694
Fixed income securities:				
U.S. Treasury	60,423	2,811	(314)	62,920
Foreign government	22,825	456	(94)	23,187
Corporate	9,715	763	(53)	10,425
Equity securities:				
Preferred stock	2,837	224	(15)	3,046
Common stock	312,320	26,418	(1,719)	337,019
Mutual funds:				
Equity	136,566	19,231	(480)	155,317
Fixed income	277,059	18,771	(1,790)	294,040
Private equity and other	26,817	2,547	(3,485)	25,879
Trust investments	\$ 1,280,256	\$ 71,221	\$ (7,950)	\$ 1,343,527
Less: Assets associated with businesses held for sale				(126,198)
				\$ 1,217,329

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

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

	<b>Market (In thousands)</b>
Due in one year or less	\$ 3,929
Due in one to five years	29,179
Due in five to ten years	40,145
Thereafter	23,279
	\$ 96,532

During the three months ended September 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$448.4 million and \$461.2 million, respectively. These sale transactions resulted in \$66.0 million and \$10.9 million of realized gains and realized losses, respectively, for the three months ended September 30, 2007. During the three months ended September 30, 2006, purchases and sales of available-for-sale securities included in trust investments were \$321.6 million and \$344.9 million, respectively. These sale transactions resulted in \$24.5 million and \$25.4 million of realized gains and realized losses, respectively for the three months ended September 30, 2006.

During the nine months ended September 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$805.4 million and \$664.8 million, respectively. These sale transactions resulted in \$102.3 million and \$23.3 million of realized gains and realized losses, respectively, for the nine months ended

September 30, 2007. During the nine months ended September 30, 2006, purchases and sales of available-for-sale securities included in trust investments were \$509.0 million and \$542.3 million, respectively. These sale transactions resulted in \$59.0 million and \$39.2 million of realized gains and realized losses, respectively for the nine months ended September 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 cemetery contract. Only the amount we are entitled to retain is recognized when a contract is cancelled. Recognized earnings (realized and unrealized) related to these trust investments were \$8.9 million and \$3.5 million for the three months ended September 30, 2007 and 2006, respectively. Recognized earnings (realized and unrealized) related to these trust investments were \$18.7 million and \$10.2 million for the nine months ended September 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 \$5.7 million and \$7.0 million into the trusts and withdrew \$4.2 million and \$9.2 million from the trusts during the three months ended September 30, 2007 and 2006,



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respectively. We deposited \$20.3 million and \$18.2 million into the trusts and withdrew \$22.9 million and \$38.5 million from the trusts during the nine months ended September 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 September 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 September 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 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. As a result of our most recent review at September 30, 2007, we recorded no additional impairment charges. See Note 9 to the condensed consolidated financial statements for further information related to our non-controlling interest in perpetual care trust investments.

	<b>September 30, 2007</b>			<b>Fair</b>
	<b>Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Market Value</b>
	<b>(In thousands)</b>			
Cash and cash equivalents	\$ 219,083	\$	\$	\$ 219,083
Fixed income securities:				
U.S. Treasury	2,113	612	(13)	2,712
Foreign government	30,838	515	(194)	31,159
Corporate	33,865	648	(299)	34,214
Mortgage-backed	5,467	3	(3)	5,467
Equity securities:				
Preferred stock	2,364	71	(16)	2,419
Common stock	110,511	10,519	(642)	120,388
Mutual funds:				
Equity	47,226	3,010	(195)	50,041
Fixed income	480,274	11,268	(3,058)	488,484
Private equity and other	28,849	2,280	(1,184)	29,945
Perpetual care trust investments	\$ 960,590	\$ 28,926	\$ (5,604)	\$ 983,912
Less: Assets associated with businesses held for sale				(67,283)
				\$ 916,629

**December 31, 2006**

	<b>Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Market Value</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

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	<b>December 31, 2006</b>		<b>Fair</b>
	<b>Cost</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>
		<b>(In thousands)</b>	
			<b>Market Value</b>
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 September 30, 2007 are estimated as follows:

	<b>Market (In thousands)</b>
Due in one year or less	\$ 12,720
Due in one to five years	30,755
Due in five to ten years	14,475
Thereafter	15,602
	\$ 73,552

During the three months ended September 30, 2007, purchases and sales of available-for-sale securities in the perpetual care trusts were \$405.6 million and \$247.3 million, respectively. These sale transactions resulted in \$6.6 million and \$5.7 million of realized gains and realized losses, respectively. During the three months ended September 30, 2006, purchases and sales of available-for-sale securities in the perpetual care trusts were \$395.4 million and \$421.4 million, respectively. These sales transactions resulted in \$20.8 million and \$17.4 million of realized gains and realized losses, respectively.

During the nine months ended September 30, 2007, purchases and sales of available-for-sale securities in the perpetual care trusts were \$632.9 million and \$341.4 million, respectively. These sale transactions resulted in \$31.0 million and \$11.9 million of realized gains and realized losses, respectively. During the nine months ended September 30, 2006, purchases and sales of available-for-sale securities in the perpetual care trusts were \$729.8 million and \$736.9 million, respectively. These sales transactions resulted in \$32.2 million and \$25.2 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 \$10.3 million and \$9.1 million for the three months ended September 30, 2007 and 2006, respectively. Recognized earnings related to these perpetual care trust investments were \$35.6 million and \$32.7 million for the nine months ended September 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 September 30, 2007 and December 31, 2006 are detailed below.

	<b>September 30, 2007</b>			<b>September 30,</b>
	<b>Preneed</b>	<b>Preneed</b>	<b>Total</b>	<b>2007</b>
	<b>Funeral</b>	<b>Cemetery</b>		<b>Cemetery</b>
	<b>(In thousands)</b>			<b>Perpetual Care</b>
Trust investments, at market value	\$ 1,325,665	\$ 1,217,329	\$ 2,542,994	\$ 916,629
Less: Accrued trust operating payables, deferred taxes and other	(4,910)	(10,275)	(15,185)	(3,184)
Non-controlling interest	\$ 1,320,755	\$ 1,207,054	\$ 2,527,809	\$ 913,445

	<b>December 31, 2006</b>			<b>December 31,</b>
	<b>Preneed</b>	<b>Preneed</b>	<b>Total</b>	<b>2006</b>
	<b>Funeral</b>	<b>Cemetery</b>		<b>Cemetery</b>
	<b>(In thousands)</b>			<b>Perpetual Care</b>
Trust investments, at market value	\$ 1,329,922	\$ 1,236,446	\$ 2,566,368	\$ 893,931
Less: Accrued trust operating payables, 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 nine months ended September 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 September 30, 2007</b>				<b>Total</b>
	<b>Funeral Trusts</b>	<b>Cemetery Trusts</b>	<b>Cemetery Perpetual Care Trusts</b>	<b>Other, Net</b>	
			<b>(In thousands)</b>		
Realized gains	\$ 54,926	\$ 65,959	\$ 6,558	\$	\$ 127,443
Realized losses	(10,781)	(10,874)	(5,718)		(27,373)
Interest, dividend and other ordinary income	5,749	10,530	8,090		24,369
Trust expenses and income taxes	(2,036)	(2,962)	(630)		(5,628)
Net trust investment income	47,858	62,653	8,300		118,811
Interest expense related to non-controlling interest in funeral and cemetery trust investments	(47,858)	(62,653)			(110,511)
Interest expense related to non-controlling interest in perpetual care trust investments			(8,300)		(8,300)
Total non-controlling interest	(47,858)	(62,653)	(8,300)		(118,811)
Other (expense), net				(1,049)	(1,049)
Total other (expense), net	\$	\$	\$	\$ (1,049)	\$ (1,049)

	<b>Nine Months Ended September 30, 2007</b>				<b>Total</b>
	<b>Funeral Trusts</b>	<b>Cemetery Trusts</b>	<b>Cemetery Perpetual Care Trusts</b>	<b>Other, Net</b>	
			<b>(In thousands)</b>		
Realized gains	\$ 87,677	\$ 102,296	\$ 30,990	\$	\$ 220,963
Realized losses	(26,418)	(26,493)	(13,101)		(66,012)
Interest, dividend and other ordinary income	17,400	25,223	30,409		73,032
Trust expenses and income taxes	(7,415)	(11,353)	(3,017)		(21,785)
Net trust investment income	71,244	89,673	45,281		206,198
Interest expense related to non-controlling interest in funeral and cemetery trust investments	(71,244)	(89,673)			(160,917)
			(45,281)		(45,281)

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

Total non-controlling interest	(71,244)	(89,673)	(45,281)		(206,198)
Other (expense), net				(3,981)	(3,981)
Total other (expense), net	\$	\$	\$	\$ (3,981)	\$ (3,981)

**Three Months Ended September 30, 2006**

	<b>Funeral Trusts</b>	<b>Cemetery Trusts</b>	<b>Cemetery Perpetual Care Trusts (In thousands)</b>	<b>Other, Net</b>	<b>Total</b>
Realized gains	\$ 15,255	\$ 24,441	\$ 20,780	\$	\$ 60,476
Realized losses	(13,739)	(25,465)	(17,349)		(56,553)
Interest, dividend and other ordinary income	3,804	6,842	6,002		16,648
Trust expenses and income taxes	(2,971)	(4,151)	(248)		(7,370)
Net trust investment income	2,349	1,667	9,185		13,201
Interest expense related to non-controlling interest in funeral and cemetery trust investments	(2,349)	(1,667)			(4,016)
Interest expense related to non-controlling interest in perpetual care trust investments			(9,185)		(9,185)
Total non-controlling interest	(2,349)	(1,667)	(9,185)		(13,201)
Other income				10,118	10,118
Total other income, net	\$	\$	\$	\$ 10,118	\$ 10,118

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	<b>Nine Months Ended September 30, 2006</b>				<b>Total</b>
	<b>Funeral Trusts</b>	<b>Cemetery Trusts</b>	<b>Cemetery Perpetual Care Trusts (In thousands)</b>	<b>Other, Net</b>	
Realized gains	\$ 49,059	\$ 58,964	\$ 32,183	\$	\$ 140,206
Realized losses	(25,494)	(39,220)	(25,151)		(89,865)
Interest, dividend and other ordinary income	11,960	25,955	29,726		67,641
Trust expenses and income taxes	(6,037)	(9,540)	(388)		(15,965)
Net trust investment income	29,488	36,159	36,370		102,017
Interest expense related to non-controlling interest in funeral and cemetery trust investments	(29,488)	(36,159)			(65,647)
Interest expense related to non-controlling interest in perpetual care trust investments			(36,370)		(36,370)
Total non-controlling interest	(29,488)	(36,159)	(36,370)		(102,017)
Other income				11,176	11,176
Total other income, net	\$	\$	\$	\$ 11,176	\$ 11,176

**10. Debt**

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

	<b>September 30, 2007</b>	<b>December 31, 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 5.00% to 5.25%, conversion prices from \$13.02 to \$50.00 per share	9,425	9,925
Obligations under capital leases	115,525	113,484
Mortgage notes and other debt, maturities through 2050	23,711	26,304
Unamortized pricing discounts and other	(5,429)	(7,553)

Total debt	1,936,296	1,958,872
Less current maturities	(156,466)	(46,176)
Total long-term debt	\$ 1,779,830	\$ 1,912,696

Current maturities of debt at September 30, 2007 were comprised primarily of our 6.5% notes due March 2008 and the October 2007 prepayment of our Series A Senior Notes due November 2011 (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 7.15% at September 30, 2007 and 7.30% at December 31, 2006. Approximately 87% and 82% of our total debt had a fixed interest rate at September 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 September 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 September 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 September 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 September 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 and the offering to exchange was completed in the third quarter of 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.

Subsequent to September 30, 2007, we repaid \$13.5 million aggregate principal amount of our 6.875% notes due October 2007. In addition to this repayment, we also prepaid \$50 million of our Series A Senior Notes due November 2011, pursuant to a contractual commitment we entered into prior to September 30, 2007.

**Capital Leases**

In the first nine months of 2007, we acquired \$27.8 million of transportation vehicles and other assets, which primarily relate to Alderwoods operations, using capital leases.

**11. Retirement Plans**

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

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	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Interest cost on projected benefit obligation	\$ 860	\$ 1,973	\$ 5,026	\$ 5,919
Actual loss (return) on plan assets	323	(1,556)	(1,612)	(4,183)
Amortization of prior service cost	46	45	138	137
Plan dissolution and other	5,089		5,089	
	\$ 6,318	\$ 462	\$ 8,641	\$ 1,873

During the third quarter of 2007, we initiated the dissolution of our SCI Cash Balance Plan by making distributions out of plan assets of \$51.6 million. These distributions reduced both Plan assets and the accumulated benefit obligation. In connection with this dissolution process, we recognized \$5.1 million in non-cash charges.

**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 nine months ended September 30, 2007:

<b>Assumptions</b>	<b>Three months ended September 30, 2007</b>	<b>Nine months ended September 30, 2007</b>
Dividend yield	1.4%	1.4%
Expected volatility	39.1%	38.9%
Risk-free interest rate	5.0%	4.8%
Expected holding period	6.0 years	5.9 years

*Stock Options*

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

	<b>Options</b>	<b>Weighted-average exercise price</b>
Outstanding at December 31, 2006	22,531,316	\$ 7.79
Granted	2,234,900	10.86
Exercised	(3,519,147)	5.69
Expired	(3,465,034)	17.92
Outstanding at September 30, 2007	17,782,035	\$ 6.61
Exercisable at September 30, 2007	14,181,578	\$ 5.83

*Restricted Shares*

Restricted share activity for the nine months ended September 30, 2007 was as follows:

<b>Restricted</b>	<b>Weighted-average grant-date</b>
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	<b>shares</b>	<b>fair value</b>
Nonvested restricted shares at December 31, 2006	795,176	\$ 7.50
Granted	313,800	10.73
Vested	(404,480)	7.29
Nonvested restricted shares at September 30, 2007	704,496	\$ 9.08

**Table of Contents****13. Stockholders Equity**

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

	<b>Foreign currency translation adjustment</b>	<b>Pension related adjustments</b>	<b>Unrealized gains and losses</b>	<b>Accumulated other comprehensive income</b>
	<b>(In thousands)</b>			
Balance at December 31, 2006	\$ 76,652	\$ (623)	\$ (3,731)	\$ 72,298
Activity in 2007	84,909	380	3,731	89,020
Decrease in net unrealized gains associated with available-for-sale securities of the trusts			(33,481)	(33,481)
Reclassification of unrealized loss activity attributable to the non-controlling interest holders			33,481	33,481
Balance at September 30, 2007	\$ 161,561	\$ (243)	\$	\$ 161,318

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*. The activity in 2007 for unrealized gains and losses includes \$5.7 million of unrealized losses on investment securities through the date of sale and the reclassification adjustments for investment losses realized in discontinued operations upon the sale of Mayflower Insurance Company. Income taxes are generally not provided for foreign currency translation.

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

	<b>Three months ended September 30, 2007</b>		<b>Nine months ended September 30, 2007</b>	
	<b>2006</b>		<b>2006</b>	
	<b>(In thousands)</b>			
Comprehensive income:				
Net income	\$ 28,170	\$ 3,365	\$ 80,930	\$ 55,741
Total other comprehensive income (loss)	47,424	(1,232)	89,020	9,729
Comprehensive income	\$ 75,594	\$ 2,133	\$ 169,950	\$ 65,470

**Cash Dividends**

On August 8, 2007, our Board of Directors approved a cash dividend of \$.03 per common share. At September 30, 2007, this dividend totaling \$8.6 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 October 31, 2007.

**Share Repurchase Program**

Subject to market conditions and normal trading and bank covenant restrictions, we make purchases in the open market or through privately negotiated transactions under our stock repurchase program. 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. In the nine months ended September 30, 2007, we repurchased 16,855,762 shares of common stock at an aggregate cost of \$211.8 million and an average cost per share of \$12.56.

After these events, the remaining dollar value of shares authorized to be purchased under the share repurchase program was approximately \$189.0 million.

Subsequent to September 30, 2007, we repurchased an additional 5,867,800 shares of common stock at an aggregate cost of \$79.4 million including commissions (average cost per share of \$13.54). After these fourth quarter repurchases, the remaining dollar value of shares authorized to be purchased under our share repurchase program was approximately \$109.5 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.

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Alderwoods operating results are included in our 2007 results. Please refer to Note 5 for pro forma presentations related to the Alderwoods acquisition for 2006.

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 reflected as discontinued operations. We conduct both funeral and cemetery operations in the United States and Canada and funeral operations in Germany.

Our reportable segment information is as follows:

	<b>Funeral</b>	<b>Cemetery (In thousands)</b>	<b>Reportable segments</b>
Revenues from external customers:			
Three months ended September 30, 2007	\$ 355,738	\$ 183,596	\$ 539,334
2006	\$ 263,935	\$ 136,454	\$ 400,389
Nine months ended September 30, 2007	\$ 1,154,468	\$ 557,913	\$ 1,712,381
2006	\$ 846,811	\$ 426,979	\$ 1,273,790
Gross profit:			
Three months ended September 30, 2007	\$ 63,587	\$ 38,933	\$ 102,520
2006	\$ 53,608	\$ 19,440	\$ 73,048
Nine months ended September 30, 2007	\$ 236,522	\$ 110,513	\$ 347,035
2006	\$ 173,572	\$ 72,358	\$ 245,930
Depreciation and amortization:			
Three months ended September 30, 2007	\$ 24,287	\$ 5,451	\$ 29,738
2006	\$ 17,068	\$ 4,365	\$ 21,433
Nine months ended September 30, 2007	\$ 74,655	\$ 17,215	\$ 91,870
2006	\$ 49,732	\$ 13,177	\$ 62,909
Amortization of cemetery property:			
Three months ended September 30, 2007	\$	\$ 7,183	\$ 7,183
2006	\$	\$ 5,846	\$ 5,846
Nine months ended September 30, 2007	\$	\$ 24,983	\$ 24,983
2006	\$	\$ 18,589	\$ 18,589
Capital expenditures:			
Nine months ended September 30, 2007	\$ 39,461	\$ 60,769	\$ 100,230
2006	\$ 23,224	\$ 35,384	\$ 58,608

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

	<b>Reportable Segments</b>	<b>Corporate</b>	<b>Consolidated</b>
Depreciation and amortization:			
Three months ended September 30, 2007	\$ 29,738	\$ 2,694	\$ 32,432

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2006	\$ 21,433	\$ 2,498	\$ 23,931
Nine months ended September 30,			
2007	\$ 91,870	\$ 7,438	\$ 99,308
2006	\$ 62,909	\$ 6,692	\$ 69,601
Capital expenditures			
Nine months ended September 30,			
2007	\$100,230	\$13,377	\$113,607
2006	\$ 58,608	\$ 4,591	\$ 63,199

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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>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Gross profit from reportable segments	\$ 102,520	\$ 73,048	\$ 347,035	\$ 245,930
General and administrative expenses	(32,074)	(20,956)	(97,754)	(63,885)
Gains (losses) on dispositions and impairment charges, net	4,886	(30,750)	6,949	(38,141)
Operating income	75,332	21,342	256,230	143,904
Interest expense	(38,090)	(33,330)	(111,852)	(86,667)
Loss on early extinguishment of debt			(14,480)	
Interest income	4,254	8,259	8,324	21,022
Equity in earnings of unconsolidated subsidiaries	2,460	1,214	8,730	1,351
Other (expense) income, net	(1,049)	10,118	(3,981)	11,176
Income from continuing operations before income taxes	\$ 42,907	\$ 7,603	\$ 142,971	\$ 90,786

Our geographic area information is as follows:

	<b>United States</b>	<b>Foreign</b>	<b>Total</b>
	<b>(In thousands)</b>		
Revenues from external customers:			
Three months ended September 30, 2007	\$ 482,441	\$ 56,893	\$ 539,334
2006	\$ 372,886	\$ 27,503	\$ 400,389
Nine months ended September 30, 2007	\$ 1,563,329	\$ 149,052	\$ 1,712,381
2006	\$ 1,186,416	\$ 87,374	\$ 1,273,790
Gains (losses) on dispositions and impairment charges, net:			
Three months ended September 30, 2007	\$ 4,282	\$ 604	\$ 4,886
2006	\$ (30,754)	\$ 4	\$ (30,750)
Nine months ended September 30, 2007	\$ 6,858	\$ 91	\$ 6,949
2006	\$ (36,586)	\$ (1,555)	\$ (38,141)
Operating income:			
Three months ended September 30, 2007	\$ 63,069	\$ 12,263	\$ 75,332
2006	\$ 16,151	\$ 5,191	\$ 21,342
Nine months ended September 30, 2007	\$ 238,679	\$ 17,551	\$ 256,230
2006	\$ 128,672	\$ 15,232	\$ 143,904



## Depreciation and amortization:

Three months ended September 30,			
2007	\$ 29,247	\$ 3,185	\$ 32,432
2006	\$ 22,276	\$ 1,655	\$ 23,931
Nine months ended September 30,			
2007	\$ 88,500	\$ 10,808	\$ 99,308
2006	\$ 64,657	\$ 4,944	\$ 69,601
Amortization of cemetery property:			
Three months ended September 30,			
2007	\$ 5,402	\$ 1,781	\$ 7,183
2006	\$ 5,352	\$ 494	\$ 5,846
Nine months ended September 30,			
2007	\$ 22,231	\$ 2,752	\$ 24,983
2006	\$ 16,937	\$ 1,652	\$ 18,589

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Depreciation expense related to property, plant, and equipment totaled \$28.6 million and \$88.0 million for the three and nine months ended September 30, 2007, respectively, and \$20.9 million and \$60.3 million for the three and nine months ended September 30, 2006, respectively.

**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 nine months ended September 30:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Merchandise revenues:				
Funeral	\$ 117,234	\$ 90,751	\$ 391,165	\$ 315,373
Cemetery	126,606	90,715	374,836	277,491
Total merchandise revenues	243,840	181,466	766,001	592,864
Services revenues:				
Funeral	224,367	163,817	726,526	502,273
Cemetery	48,686	39,516	158,146	127,262
Total services revenues	273,053	203,333	884,672	629,535
Other revenues	22,441	15,590	61,708	51,391
Total revenues	\$ 539,334	\$ 400,389	\$ 1,712,381	\$ 1,273,790
Merchandise costs and expenses:				
Funeral	\$ 58,740	\$ 42,469	\$ 194,689	\$ 147,187
Cemetery	49,206	37,717	151,206	116,674
Total cost of merchandise	107,946	80,186	345,895	263,861
Services costs and expenses:				
Funeral	116,464	79,371	357,710	258,170
Cemetery	27,600	23,546	84,782	71,159
Total cost of services	144,064	102,917	442,492	329,329
Overhead and other expenses	184,804	144,238	576,959	434,670
Total costs and expenses	\$ 436,814	\$ 327,341	\$ 1,365,346	\$ 1,027,860

**16. Commitments and Contingencies*****Representations and Warranties***

As of September 30, 2007, we have contingent obligations of \$30.3 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 \$7.3 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 nine months of 2007, we paid \$0.2 million to settle certain tax and litigation matters. The remaining obligation of \$23.5 million at September 30, 2007 represents the following:

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	<b>Contractual Obligation (In thousands)</b>	<b>Time Limit</b>	<b>Maximum Potential Amount of Future Payments</b>	<b>Carrying Value as of September 30, 2007  (In 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)	4,122
Employee litigation provision	6,512	Until entire resolution of (i) the relevant claims or (ii) settlement of the claim by the purchaser at the request of the vendor	(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			\$ 27,897
Less: Deductible of majority equity owner	(4,382)			(4,382)
	\$ 35,768			\$ 23,515

(1) The potential maximum exposure for these two items combined is 20.0 million or \$28.5 million at September 30, 2007.

(2) The potential maximum exposure for

these two items  
combined is  
40.0 million or  
\$57.0 million at  
September 30,  
2007.

Subsequent to September 2007, we sold our remaining interest in our French operations. This sale does not substantially change our remaining obligations. For additional information on the disposition, see Note 18.

### **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 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,

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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 on two occasions; however, the dismissals were without prejudice. 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 *Hijar Lawsuit* satisfies the requirements for class certification.

In May 2004, the trial court heard summary judgment cross-motions filed by us and plaintiff *Hijar* (at that time, the only plaintiff). The trial court granted *Hijar'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 *Hijar 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 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.

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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 Court requested a response which we filed on August 21, 2007. On September 28, 2007 the Court denied plaintiffs' petition for review.

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. On October 12, 2007, the Supreme Court of Texas granted our mandamus request and directed the trial court to vacate its sanction orders.

*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.

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

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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.

*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 and denied without prejudice plaintiffs' request for certification of claims against SCI. Plaintiffs have filed an amended complaint in an effort to make a class claim 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>Nine months ended</b>	
	<b>September 30,</b>		<b>September 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	\$ 28,845	\$ 2,806	\$ 76,471	\$ 54,940
(Loss) income from discontinued operations, net of tax	(675)	559	4,459	801
Net income	\$ 28,170	\$ 3,365	\$ 80,930	\$ 55,741
Denominator:				
Weighted average shares basic	284,511	291,662	289,437	293,117
Stock options	4,866	4,064	5,188	4,079
Restricted stock	220	192	223	157
Weighted average shares diluted	289,597	295,918	294,848	297,353

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Income from continuing operations per share:

Basic	\$ .10	\$ .01	\$ .26	\$ .19
Diluted	\$ .10	\$ .01	\$ .26	\$ .19

Income from discontinued operations per share, net of tax:

Basic	\$	\$	\$ .02	\$
Diluted	\$	\$	\$ .01	\$

Net income per share:

Basic	\$ .10	\$ .01	\$ .28	\$ .19
Diluted	\$ .10	\$ .01	\$ .27	\$ .19

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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):

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30, 2007</b>	<b>2006</b>	<b>September 30, 2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Antidilutive options	200	7,063	198	6,847
Antidilutive convertible debentures	305	627	309	640
Total common stock equivalents excluded from computation	505	7,690	507	7,487

**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*.

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

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30, 2007</b>	<b>2006</b>	<b>September 30, 2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Gains (losses) on dispositions, net	\$ 6,069	\$ (18,344)	\$ 27,275	\$ (22,034)
Impairment losses on assets held for sale	(1,183)	(12,406)	(20,326)	(16,107)
	\$ 4,886	\$ (30,750)	\$ 6,949	\$ (38,141)

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 first nine months of 2007, we divested 52 of these properties. We have divested the remaining three properties in the fourth 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 FTC-mandated properties that were sold in October, have been classified as assets held for sale in our September 30, 2007 and December 31, 2006 consolidated balance sheets.

Net assets held for sale were as follows:

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
	<b>(In thousands)</b>	
Assets:		
Current assets	\$ 5,404	\$ 6,330
Preneed funeral receivables and trust investments	31,872	56,968
Preneed cemetery receivables and trust investments	137,580	107,796
Cemetery property	44,402	65,448
Property and equipment, at cost (net)	47,769	23,829
Deferred charges and other assets	18,716	13,914

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Goodwill	2,444	27,127
Cemetery perpetual care trust investments	67,283	54,229
Total assets	355,470	355,641
Liabilities:		
Accounts payable and accrued liabilities	199	419
Deferred preneed funeral revenues	36,270	66,841
Deferred preneed cemetery revenues	164,811	117,604
Other liabilities	1,684	1,126
Non-controlling interest in perpetual care trusts	67,283	54,229
Total liabilities	270,247	240,219
Net assets held for sale	\$ 85,223	\$ 115,422

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

Subsequent to September 2007, we sold our 25% equity interest in our French operations for 12.0 million euros, or \$17.0 million. In connection with this sale, we received 101.5 million euros, or \$144.0 million, in cash from the redemption of the remainder of our convertible preferred equity certificates which were received in connection with the original disposition of our operations in France in March 2004. In addition, 10 million euros, or approximately \$14.1 million, related to the redemption were deposited into a euro-denominated escrow account.

**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**

In July 2007, we completed the sale of our Mayflower National Life Insurance Company, Alderwoods former insurance subsidiary, to Assurant Inc. for proceeds of approximately \$67.5 million. We recognized a \$1.5 million gain related to this business in the third quarter of 2007. The operations of this subsidiary are presented as discontinued operations in our condensed consolidated statement of operations.

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 nine months ended September 30, 2007 and 2006 were as follows:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Revenues	\$	\$ 1,414	\$ 42,626	\$ 4,208
Gain on disposition	1,548		1,548	
Costs and other expenses		(1,056)	(36,448)	(3,525)
Other income			916	
Income from discontinued operations before income taxes	1,548	358	8,642	683
(Provision) benefit for income taxes	(2,223)	201	(4,183)	118
Income from discontinued operations	\$ (675)	\$ 559	\$ 4,459	\$ 801

**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 \$109.5 million authorized to repurchase our common stock, subject to bank covenant restrictions. Our financial stability is further enhanced by our \$6.4 billion backlog of future revenues at September 30, 2007,

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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.

### **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 nine months of 2007, we generated \$234.4 million of proceeds from divestitures of these properties, which included 52 FTC-mandated properties. In addition, we sold Mayflower National Life Insurance Company, Alderwoods former insurance subsidiary, for \$67.5 million in the third quarter of 2007. Additionally, in the fourth quarter of 2007, we sold our 25% equity interest in French operations, for \$12.0 million euros, or \$17.0 million. In connection with this sale, we received 101.5 million euros, or \$144.0 million, in cash from the redemption of the remainder of our convertible preferred equity certificates which were received in connection with the original disposition of our operations in France in March 2004. In addition, 10 million euros, or approximately \$14.1 million, related to the redemption were deposited into a euro-denominated escrow account.

At September 30, 2007, our current liabilities exceeded our current assets as a result of using \$608 million of available cash in the Alderwoods transaction as well as our decision to prepay \$50 million of our Series A Senior Notes due November 2011 in October 2007, pursuant to a contractual commitment we entered into prior to September 30, 2007. We believe our future operating cash flows and available capacity under our credit facility will be adequate to meet our working capital requirement.

#### ***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 nine months ended September 30, 2007 and 2006 are as follows:

*Operating Activities* Cash flows from operating activities in the first nine months of 2007 were \$328.6 million compared to \$265.3 million in the first nine months of 2006. Included in the first nine months of 2007 are one-time transition costs of \$24.7 million related to the Alderwoods acquisition and integration and \$11.4 million of premiums paid on the early extinguishment of debt. In the first nine months of 2007, the receipt of \$26.1 million in trust proceeds arising



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from our recent reconciliations of the preneed funeral and cemetery backlogs of Alderwoods and \$31.5 million from our internal working capital improvement initiatives were essentially offset by other working capital declines. These declines included \$20.7 million in additional interest payments resulting from increased borrowings to finance the Alderwoods acquisition, \$17.2 million in additional cash tax payments and a \$12.7 million decline in cash interest received. In addition, cash flows in the first nine months of 2006 were positively impacted by the receipt of \$7.9 million of endowment care trust fund income. After taking into account the above items, the remaining increase in cash flows from operating activities in the first nine months of 2007 was primarily driven by operating cash flows generated as a result of adding the Alderwoods locations to our company.

*Investing Activities* Cash flows from investing activities increased \$189.9 million in the first nine months of 2007 compared to the first nine months of 2006 primarily due to a \$259.5 million increase in proceeds from sales of businesses in North America. In the first quarter of 2006, we sold the 280,952 StoneMor Partners LP units received in the fourth quarter of 2005 related to the disposition of assets. The proceeds from the sale of these units totaled \$5.9 million. Offsetting these proceeds, our capital expenditures increased \$50.4 million in the first nine months of 2007 compared to the same period of 2006, primarily due to additional capital expenditures related to the acquired Alderwoods locations.

*Financing Activities* Cash used in financing activities increased \$194.2 million in the first nine months of 2007 compared to the same period in 2006 primarily due to the early extinguishment of debt and an increase in share repurchases partially offset by proceeds from the issuance of long term debt and a decrease in scheduled debt payments.

Proceeds from long-term debt (net of issuance costs) were \$392.6 million in 2007 due to the issuance of \$200.0 million of senior unsecured 6.75% notes due in 2015 and \$200.0 million of senior unsecured 7.50% notes due in 2027.

Payments of debt in 2007 were \$447.6 million due to the acceptance of the tender of \$149.8 million of our 6.50% senior notes due 2008, and \$173.8 million of our 7.70% senior notes due 2009, a \$100.0 million repayment of our term loan, \$3.0 million in scheduled debt payments, and \$22.1 million in payments on capital leases. The \$30.3 million in debt payments in 2006 were related to \$14.3 million in scheduled debt payments and \$16.0 million in payments on capital leases.

**Contractual, Commercial, and Contingent Commitments**

We have assumed various financial obligations and commitments in the ordinary course of conducting our business. We have contractual obligations requiring future cash payments under existing contractual arrangements. We also have commercial and contingent obligations that result in cash payments only if certain events occur requiring our performance pursuant to a funding commitment. These contingent obligations include uncertain tax positions for which we are unable at this time to make a reliable estimate of the timing of future cash settlements.

Our known future cash payments (on an undiscounted basis) are consistent with those reported in our Annual Report on Form 10-K except for those detailed in the following table:

Contractual, Commercial, and Contingent Obligations	Expiration by Period				Total
	Remainder of 2007	2008-2009	2010-2011	Thereafter	
	(Dollars in millions)				
Long-term debt maturities (1)	\$ 83.3	\$ 147.0	\$ 227.7	\$ 1,478.3	\$ 1,936.3
Interest obligation on long-term debt	60.3	255.8	240.8	675.9	1,232.8
<b>Total</b>	<b>\$ 143.6</b>	<b>\$ 402.8</b>	<b>\$ 468.5</b>	<b>\$ 2,154.2</b>	<b>\$ 3,169.1</b>

(1) 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. 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.



**Table of Contents****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 preneed funeral and cemetery sales activities that are not backed by trust investments. 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>September 30, 2007</b>	<b>December 31, 2006</b>
	<b>(Dollars in millions)</b>	
Preneed funeral	\$ 134.9	\$ 137.0
Preneed cemetery:		
Merchandise and services	143.7	162.0
Pre-construction	6.4	8.6
 Bonds supporting preneed funeral and cemetery obligations	 285.0	 307.6
 Bonds supporting preneed business permits	 5.3	 3.6
Other bonds	14.5	12.4
 Total surety bonds outstanding	 \$ 304.8	 \$ 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 September 30, 2007 and 2006, we had \$9.3 million and \$12.4 million, respectively, of cash receipts attributable to bonded sales. For the nine months ended September 30, 2007 and 2006, we had \$29.9 million and \$40.6 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 September 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 nine months ended September 30, 2007 and 2006.

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	<b>North America</b>			
	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 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	\$ 38.0	\$ 31.0	\$ 112.8	\$ 95.6
Sales production (number of contracts)	7,282	6,885	23,429	22,126
Maturities	\$ 47.5	\$ 35.5	\$ 150.9	\$ 122.3
Maturities (number of contracts)	10,431	8,691	35,712	28,985
<b>Cemetery:</b>				
Sales production:				
Preneed	\$ 96.0	\$ 72.6	\$ 299.5	\$ 233.5
Atneed	73.5	53.3	218.1	164.3
Total sales production	\$ 169.5	\$ 125.9	\$ 517.6	\$ 397.8
Sales production deferred to backlog:				
Preneed	\$ 42.6	\$ 34.9	\$ 134.3	\$ 114.6
Atneed	47.8	39.1	156.8	121.8
Total sales production deferred to backlog	\$ 90.4	\$ 74.0	\$ 291.1	\$ 236.4
Revenue recognized from backlog:				
Preneed	\$ 44.3	\$ 34.3	\$ 124.6	\$ 95.4
Atneed	49.5	38.5	154.4	119.2
Total revenue recognized from backlog	\$ 93.8	\$ 72.8	\$ 279.0	\$ 214.6

*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 nine months ended September 30, 2007 and 2006, and the number of contracts associated with those transactions.

	<b>North America</b>	
	<b>Three months ended</b>	<b>Nine months ended</b>
	<b>September 30,</b>	<b>September 30,</b>

	2007	2006	2007	2006
		(Dollars in millions)		
Preneed funeral insurance-funded(1):				
Sales production	\$ 73.5	\$ 48.4	\$ 223.0	\$ 144.5
Sales production (number of contracts)	12,828	9,139	39,170	27,868
General agency revenue	\$ 14.2	\$ 8.0	\$ 36.8	\$ 24.6
Maturities	\$ 56.7	\$ 44.0	\$ 186.3	\$ 140.0
Maturities (number of contracts)	11,281	8,812	39,341	29,001

(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 September 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 September 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.

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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.

	<b>North America</b>			
	<b>September 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	\$ 1.63	\$ 1.60	\$ 1.66	\$ 1.62
Backlog of insurance-funded preneed funeral revenues	\$ 2.98	\$ 2.98	\$ 2.98	\$ 2.98
Total backlog of preneed funeral revenues	\$ 4.61	\$ 4.58	\$ 4.64	\$ 4.60
Assets associated with backlog of trust-funded deferred preneed funeral revenues, net of estimated allowance for cancellation	\$ 1.40	\$ 1.37	\$ 1.45	\$ 1.41
Insurance policies associated with insurance-funded deferred preneed funeral revenues, net of estimated allowance for cancellation	\$ 2.98	\$ 2.98	\$ 2.98	\$ 2.98
Total assets associated with backlog of preneed funeral revenues	\$ 4.38	\$ 4.35	\$ 4.43	\$ 4.39
Backlog of deferred cemetery revenues	\$ 1.81	\$ 1.75	\$ 1.85	\$ 1.78
Assets associated with backlog of deferred cemetery revenues, net of estimated allowance for cancellation	\$ 1.30	\$ 1.25	\$ 1.36	\$ 1.30

The market value of funeral and cemetery trust investments was based primarily on quoted market prices at September 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 September 30, 2007 and 2006****Management Summary**

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

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

North America funeral services performed increased 16,177, or 31.0%, in the third quarter of 2007 compared to the third quarter of 2006 as a result of locations acquired in the Alderwoods transaction; and

comparable cemetery revenues increased \$13.9 million in the third quarter of 2007 compared to the prior year due to increases associated with constructed cemetery property.

**Results of Operations**



In the third quarter of 2007, we reported net income of \$28.1 million (\$.10 per diluted share) compared to net income in the third quarter of 2006 of \$3.3 million (\$.01 per diluted share). These results were impacted by the following items:

a net after-tax loss on asset sales and other non-recurring income taxes of \$22.2 million in the third quarter of 2006 and

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an after-tax gain on asset sales of \$5.1 million in the third quarter of 2007.

**Consolidated Versus Comparable Results**

The table below reconciles our consolidated GAAP results to our comparable, or same store, results for the three months ended September 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 September 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.

Three months ended September 30, 2007	Consolidated	Less: Activity Associated with Acquisition/ New Construction		Comparable
		Construction	Less: Activity Associated with Dispositions	
(Dollars in millions)				
North America				
Funeral revenue	\$ 353.8	\$ 97.6	\$ 3.7	\$ 252.5
Cemetery revenue	183.6	39.6	(0.1)	144.1
	537.4	137.2	3.6	396.6
Germany				
Funeral revenue	1.9			1.9
Total revenues	\$ 539.3	\$ 137.2	\$ 3.6	\$ 398.5
North America				
Funeral gross profits	\$ 63.4	\$ 18.8	\$ (1.8)	\$ 46.4
Cemetery gross profits	38.9	6.5	(0.8)	33.2
	102.3	25.3	(2.6)	79.6
Germany				
Funeral gross profits	0.2			0.2
Total gross profits	\$ 102.5	\$ 25.3	\$ (2.6)	\$ 79.8

Three months ended September 30, 2006	Consolidated	Less: Activity Associated with Acquisition/ New Construction		Comparable
		Construction	Less: Activity Associated with Dispositions	
(Dollars in millions)				
North America				

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Funeral revenue	\$ 262.3	\$ 0.8	\$ 11.0	\$ 250.5
Cemetery revenue	136.5	0.6	5.7	130.2
	398.8	1.4	16.7	380.7
Germany				
Funeral revenue	1.6			1.6
Total revenues	\$ 400.4	\$ 1.4	\$ 16.7	\$ 382.3
North America				
Funeral gross profits	\$ 53.5	\$ 0.1	\$ 0.5	\$ 52.9
Cemetery gross profits	19.5	0.1	(0.3)	19.7
	73.0	0.2	0.2	72.6
Germany				
Funeral gross profits				
Total gross profits	\$ 73.0	\$ 0.2	\$ 0.2	\$ 72.6

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The following table provides the data necessary to calculate our consolidated average revenue per funeral service in North America for the three months ended September 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.

	<b>Three months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Dollars in millions, except average revenue per funeral service)</b>	
North America funeral revenue	\$ 353.8	\$ 262.3
Less: GA revenues	14.1	9.5
Kenyon revenues	0.8	0.9
 Adjusted North America funeral revenue	 \$ 338.9	 \$ 251.9
 North America funeral services performed	 68,356	 52,179
North America average revenue per funeral service	\$ 4,959	\$ 4,826

The following table provides the data necessary to calculate our comparable average revenue per funeral service in North America for the three months ended September 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 September 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Dollars in millions, except average revenue per funeral service)</b>	
Comparable North America funeral revenue	\$ 252.5	\$ 250.5
Less: GA revenues and other	10.8	9.1
Kenyon revenues	0.8	0.9
 Adjusted comparable North America funeral revenue	 \$ 240.9	 \$ 240.5
 Comparable North America funeral services performed	 47,713	 49,418
Comparable North America average revenue per funeral service	\$ 5,051	\$ 4,864

**Funeral Results***Funeral Revenue*

Consolidated revenues from funeral operations were \$355.7 million in the three months ended September 30, 2007 compared to \$263.9 million in the same period of 2006. The increase is primarily a result of the addition of Alderwoods and other operations, which contributed an additional \$96.8 million in funeral revenues in the third quarter of 2007. This increase was partially offset by planned divestitures, which contributed an incremental \$7.3 million of revenue in the third quarter of 2006. Comparable funeral revenues were up \$2.3 million, or 0.9%, compared to the third quarter of 2006.

*Funeral Services Volume*

Our consolidated funeral services volume increased 16,177, or 31.0%, in the third quarter of 2007 compared to the same period in 2006. This increase includes 20,371 funeral services performed by locations acquired in the Alderwoods transaction. This increase was partially offset by a decrease from divested locations of 2,489 funeral services. Additionally, our comparable funeral services performed decreased 1,705, or 3.5%, which we partially attribute to a decrease in the number of deaths in the markets in which we operate. We have also experienced an expected loss of market share in highly discounted, low-service cremation funeral services due to our decision to exit certain cremation businesses and in keeping with our customer segmentation strategy, which directs our resources and focus to more profitable 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 41.7% in the three months ended September 30, 2007 was consistent with the 41.6% 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.

**Table of Contents***Average Revenue Per Funeral*

Our consolidated average revenue per funeral service increased \$133, or 2.8%, in the three months ended September 30, 2007 over the same period of 2006. Our comparable average revenue per funeral service (which excludes the Alderwoods locations) increased 3.8%, or \$187 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 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 nine months of 2007 and will continue to expand to other former Alderwoods locations in the fourth quarter 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 \$10.1 million in the third quarter of 2007 compared to the third quarter of 2006 primarily due to gross profit contributed from former Alderwoods operations. The consolidated gross margin percentage decreased to 17.9% from 20.3% due primarily to Alderwoods operations that historically have had lower gross profit margins. In addition, we divested locations that contributed an incremental \$2.3 million of gross profit in the third quarter of 2006 compared to the third quarter of 2007. Gross profit from our comparable funeral locations decreased \$6.3 million, or 11.9%. Soft comparable revenue growth was not adequate to cover inflationary cost increases. Additionally, our corporate and field office overhead includes costs related to the addition of Alderwoods funeral homes and cemeteries. We cannot separately identify and allocate these additional overhead costs and therefore they negatively impact our gross profit and gross margin percentage for 2007 on a comparable basis.

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

Consolidated revenues from our cemetery operations increased \$47.1 million, or 34.5%, in the third quarter of 2007 compared to the third quarter of 2006, reflecting a \$39.0 million revenue contribution from operations acquired from Alderwoods. This increase was partially offset by a \$5.8 million decline in revenue from divested locations. Our comparable cemetery revenues of \$144.1 million in the third quarter of 2007 increased \$13.9 million, or 10.7% compared to the same period of 2006, due to increases associated with constructed cemetery property and increased trust fund income in the third quarter of 2007.

*Cemetery Gross Profits*

Consolidated cemetery gross profit increased \$19.4 million, or 99.5%, in the third quarter of 2007 compared to the third quarter of 2006 reflecting the addition of gross profit from former Alderwoods locations. Our comparable cemetery gross profit increased \$13.5 million, or 68.5%, in the third quarter of 2007 compared to the third quarter of 2006 and our comparable cemetery gross margin percentage increased to 23.0% compared to 15.1% in the same period of 2006 driven by the revenue growth described above coupled with effective cost management.

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

General and administrative expenses were \$32.1 million in the third quarter of 2007 compared to \$21.0 million in the third quarter of 2006. General and administrative costs increased \$11.1 million primarily due to \$5.1 million of non-cash costs incurred in connection with the dissolution of our SCI Cash Balance Defined Benefit Plan and \$3.3 million of one-time transition and other expenses, including severance, related to the acquisition of Alderwoods.

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

In the third quarter of 2007, we recognized a \$4.9 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 third quarter of 2006, we recognized a \$30.8 million net pretax loss from impairments and asset divestitures primarily associated with underperforming funeral and cemetery businesses in the United States and Canada.

*Interest Expense*

Interest expense increased to \$38.1 million in the third quarter of 2007, compared to \$33.3 million in the third quarter of 2006 as a result of increased borrowings to finance the Alderwoods acquisition.

*Interest Income*

Interest income of \$4.3 million in the third quarter of 2007 represents a \$4.0 million decrease from the third quarter of 2006, as expected due to decreases in our average cash balance.

*Equity in Earnings of Unconsolidated Subsidiaries*

Equity income from our equity investment in operations in France was \$2.5 million for the third quarter of 2007 and \$1.2 million for the third quarter of 2006. The increase was a result of AKH Luxco's restructuring of capital and debt instruments in 2006.

*Other (Expense) Income, Net*

Other (expense) income, net was a \$1.0 million expense in the third quarter of 2007, compared to \$10.1 million in income in the third quarter of 2006 primarily due to investment income of \$10.9 million, which was received and recognized in the third quarter of 2006 from the redemption of convertible preferred equity certificates received in connection with the original disposition of our operations in France in March 2004.

*(Provision) Benefit for Income Taxes*

The consolidated effective tax rate in the third quarter of 2007 resulted in a provision of 32.8%, compared to a provision of 63.1% in the third quarter of 2006. The lower effective tax rate for the three months ended September 30, 2007 was positively impacted by a net decrease in our liability for uncertain tax positions, a favorable adjustment for tax returns filed, and state tax law changes.

*Weighted Average Shares*

The diluted weighted average number of shares outstanding was 289.6 million in the third quarter of 2007, compared to 295.9 million in the third quarter of 2006, reflecting our share repurchase program.

**Table of Contents****Results of Operations Nine Months Ended September 30, 2007 and 2006****Management Summary**

Key highlights in the first nine months of 2007 were as follows:

an improvement in the first nine months of 2007 gross margin percentage to 20.3% from 19.3% in the first nine months of 2006;

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

North America funeral services performed increased 57,109, or 33.2%, in the first nine months of 2007 compared to the first nine months of 2006 as a result of locations acquired in the Alderwoods transaction; and

Comparable cremation rates were 41.7% in the first nine months of 2007 and 41.8% in the first nine months 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 nine months of 2007, we reported net income of \$80.9 million (\$.27 per diluted share) compared to net income in the same period of 2006 of \$55.7 million (\$.19 per diluted share). These results were impacted by certain items that decreased earnings, including:

net after-tax losses on asset sales and other non-recurring income taxes of \$13.2 million and \$28.9 million in the first nine months of 2007 and 2006, respectively;

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

after-tax one-time transition and other expenses related to our recent Alderwoods acquisition of \$11.6 million in the first nine months of 2007.

**Consolidated Versus Comparable Results**

The table below reconciles our consolidated GAAP results to our comparable, or same store, results for the nine months ended September 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 September 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.

Nine months ended September 30, 2007	Consolidated	Less:		Comparable
		Activity Associated with Acquisition/New Construction	Activity Associated with Dispositions	
		(Dollars in millions)		
North America				
Funeral revenue	\$ 1,149.4	\$ 306.1	\$ 40.5	\$ 802.8
Cemetery revenue	557.9	130.6	8.0	419.3
	1,707.3	436.7	48.5	1,222.1

Germany



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Funeral revenue	5.1				5.1
Total revenues	\$ 1,712.4	\$ 436.7	\$ 48.5	\$ 1,227.2	
North America					
Funeral gross profits	\$ 236.3	\$ 67.4	\$ 1.6	\$ 167.3	
	41				

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Nine months ended September 30, 2007	Consolidated	Less: Activity Associated with Acquisition/ New	Less: Activity Associated with Dispositions	Comparable
		Construction	(Dollars in millions)	
Cemetery gross profits	110.5	25.8	(1.8)	86.5
	346.8	93.2	(0.2)	253.8
Germany Funeral gross profits	0.2			0.2
Total gross profits	\$ 347.0	\$ 93.2	\$ (0.2)	\$ 254.0

Nine months ended September 30, 2006	Consolidated	Less: Activity Associated with Acquisition/ New	Less: Activity Associated with Dispositions	Comparable
		Construction	(Dollars in millions)	
North America Funeral revenue	\$ 842.0	\$ 1.7	\$ 44.0	\$ 796.3
Cemetery revenue	427.0	1.2	18.8	407.0
	1,269.0	2.9	62.8	1,203.3
Germany Funeral revenue	4.8			4.8
Total revenues	\$ 1,273.8	\$ 2.9	\$ 62.8	\$ 1,208.1
North America Funeral gross profits	\$ 173.1	\$ 0.2	\$ 4.5	\$ 168.4
Cemetery gross profits	72.4		(1.4)	73.8
	245.5	0.2	3.1	242.2
Germany Funeral gross profits	0.4			0.4
Total gross profits	\$ 245.9	\$ 0.2	\$ 3.1	\$ 242.6

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The following table provides the data necessary to calculate our consolidated average revenue per funeral service in North America for the nine months ended September 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.

	<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Dollars in millions, except average revenue per funeral service)</b>	
North America funeral revenue	\$ 1,149.4	\$ 842.0
Less: GA revenues	36.8	29.2
Kenyon revenues	3.6	2.9
 Adjusted North America funeral revenue	 \$ 1,109.0	 \$ 809.9
 North America funeral services performed	 229,028	 171,919
North America average revenue per funeral service	\$ 4,842	\$ 4,711

The following table provides the data necessary to calculate our comparable average revenue per funeral service in North America for the nine months ended September 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>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(Dollars in millions, except average revenue per funeral service)</b>	
Comparable North America funeral revenue	\$ 802.8	\$ 796.3
Less: GA revenues and other	30.5	27.9
Kenyon revenues	3.6	2.9
 Adjusted comparable North America funeral revenue	 \$ 768.7	 \$ 765.5
 Comparable North America funeral services performed	 154,351	 161,211
Comparable North America average revenue per funeral service	\$ 4,981	\$ 4,748

**Table of Contents*****Funeral Results******Funeral Revenue***

Consolidated revenues from funeral operations were \$1,154.5 million in the nine months ended September 30, 2007 compared to \$846.8 million in the same period of 2006. The increase is primarily a result of the addition of Alderwoods and other operations, which contributed an additional \$304.4 million in funeral revenues in the first nine months of 2007. Alderwoods average revenue per funeral service for the first nine months of 2007 was approximately 2% above our expectations and Alderwoods funeral case volume was approximately 2% below our expectations, which we believe is generally consistent with death trends in North America in the first nine months of 2007. In addition, we divested locations that contributed \$3.5 million of incremental revenue in the first nine months of 2006. Our comparable funeral revenues were up \$6.8 million, or 0.8% compared to the first nine months of 2006.

***Funeral Services Volume***

Our consolidated funeral services volume increased 57,109, or 33.2%, in the first nine months of 2007 compared to the same period in 2006. This increase includes 72,030 funeral services performed by locations acquired in the Alderwoods transaction. This increase was partially offset by a decrease from divested locations of 8,061 funeral services. Additionally, our comparable funeral services performed decreased 6,860, or 4.3%, which we attribute to certain local business decisions to exit unprofitable business relationships, primarily related to highly-discounted, low-service cremation funeral activities, and a decrease in the number of deaths in our markets in the first nine months 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 nine months ended September 30, 2007 was down compared to 41.8% 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 \$131, or 2.8%, in the nine months ended September 30, 2007 over the same period of 2006. Our comparable average revenue per funeral service (which excludes the Alderwoods locations) increased 4.9%, or \$233 per funeral service, reflecting the continued benefits from our strategic pricing initiative at legacy locations. Pursuant to this 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 nine months of 2007 and will continue to expand to other former Alderwoods locations in the fourth quarter 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 \$63.0 million in the first nine months of 2007 compared to the first nine months of 2006 primarily due to additional gross profit contributed from former Alderwoods and other operations of \$67.2 million. We divested locations that contributed an incremental \$2.9 million of gross profit in the first nine months of 2006 compared to the first nine months of 2007. The consolidated gross margin percentage of 20.5% was flat compared to the prior year. Gross profit from our comparable funeral locations decreased \$1.3 million or 0.8%, and our gross margin percentage decreased to 20.7% from 21.1% in the first nine months of 2007 compared the same period of 2006. Comparable gross profits before allocation of corporate and field overhead costs increased \$11.7 million, or 5.3%. Our corporate and field overhead includes costs related to the addition of Alderwoods funeral homes and cemeteries. We cannot separately identify and allocate these additional overhead costs and therefore they negatively impact our gross profit and gross margin percentage for 2007 on a comparable basis.

**Table of Contents*****Cemetery Results******Cemetery Revenue***

Consolidated revenues from our cemetery operations increased \$130.9 million, or 30.7%, in the first nine months of 2007 compared to the first nine months of 2006, reflecting a \$129.4 million increase from operations acquired from Alderwoods. This increase was partially offset by a \$10.8 million decline in revenue from divested locations. Our comparable cemetery revenues rose \$12.3 million, or 3.0% in the first nine months of 2007 compared to the same period of 2006, as increases associated with our constructed cemetery property and higher trust fund income were partially offset by the receipt and recognition of \$7.9 million of endowment care trust fund income in the second quarter of 2006.

***Cemetery Gross Profits***

Consolidated cemetery gross profit increased \$38.1 million, or 52.6%, in the first nine months of 2007 compared to the first nine months of 2006 reflecting the addition of gross profit from former Alderwoods operations of \$25.8 million, partially offset by divested locations with incremental gross profits in 2006 compared to 2007 of \$0.4 million. Consolidated cemetery gross margin percentage grew to 19.8% in the first nine months of 2007 compared to 16.9% in the same period of 2006. Our comparable cemetery gross profit increased \$12.7 million, or 17.2% in the first nine months of 2007 compared to the first nine months of 2006 as increases in revenue were offset by the receipt and recognition of \$7.9 million of endowment care trust fund income in the first nine months of 2006. Comparable cemetery margin percentage was 20.6% in the first half of 2007 compared to 18.1% in the first half of 2006.

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

General and administrative expenses were \$97.8 million in the first nine months of 2007 compared to \$63.9 million in the first nine months of 2006. General and administrative costs increased \$33.9 million primarily due to \$18.9 million of one-time transition expenses, including severance, related to the acquisition of Alderwoods. Additionally, salary expense increased \$5.9 million as a result of Alderwoods corporate expenses that are expected to wind down throughout 2007 and \$5.1 million of non-cash costs incurred in connection with the dissolution of our SCI Cash Balance Defined Benefit Plan.

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

In the first nine months of 2007, we recognized a \$6.9 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 nine months of 2006, we recognized a \$38.1 million net pretax loss from impairments and asset divestitures primarily associated with underperforming funeral and cemetery businesses in the United States and Canada.

***Interest Expense***

Interest expense increased to \$111.9 million in the first nine months of 2007, compared to \$86.7 million in the first nine months of 2006 as a result of increased borrowings to finance the Alderwoods acquisition.

***Interest Income***

Interest income of \$8.3 million in the first nine months of 2007 represents a \$12.7 million decrease from the first nine months of 2006, as expected due to decreases in our average cash balance.

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*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 \$8.7 million for the first nine months of 2007 and \$1.4 million for the first nine months of 2006. The increase was a result of AKH Luxco's restructuring of capital and debt instruments in 2006.

*Other (Expense) Income, Net*

Other (expense) income, net was a \$4.0 million expense in the first nine months of 2007, compared to \$11.2 million in income in the first nine months of 2006 primarily due to investment income of \$10.9 million, which was received and recognized in the third quarter of 2006 from the redemption of convertible preferred equity certificates received in connection with the original disposition of our operations in France in March 2004.

*(Provision) Benefit for Income Taxes*

The consolidated effective tax rate in the first nine months of 2007 resulted in a provision of 46.5%, compared to a provision of 39.5% in the same period of 2006. The effective tax rate for the nine months ended September 30, 2007 was negatively impacted by permanent differences between the book and tax bases of asset dispositions, state income taxes, and newly required interest and penalties accrued on uncertain tax positions.

*Weighted Average Shares*

The diluted weighted average number of shares outstanding was 294.8 million in the first nine months of 2007, compared to 297.4 million in the same period 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



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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.

**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***

On November 28, 2006, we completed our acquisition of Alderwoods. In connection with our integration of Alderwoods, we have made changes to our internal control over financial reporting that affect both Alderwoods and our legacy accounting systems and processes. Additionally, over the course of 2006 and 2007, we have outsourced certain of our accounting functions and implemented oversight controls related to these outsourced functions. As a result of the activities associated with these recent integration and outsourcing efforts, certain of our previously designed controls over financial reporting did not operate effectively in the third quarter of 2007, including controls related to: (i) the oversight and monitoring of our outsourced accounting functions and (ii) the completion and review of our balance sheet account reconciliations, including reconciliations related to certain trust accounts, cemetery properties, leases, divested properties, and income taxes.

During the third quarter 2007, we implemented temporary control procedures to address the risk of material misstatement to our consolidated financial statements resulting from the identified control deficiencies described above. Such temporary control procedures included our assigning a dedicated team of personnel to review all account reconciliations, including reconciliations related to our outsourced accounting functions. Absent these temporary control procedures, our existing controls over the areas described above might not have operated at the level necessary to prevent or detect a material misstatement on a timely basis. These temporary control procedures will remain in place until management re-designs and places in operation effective control processes, including processes related to the monitoring of our outsourced accounting functions and the timely preparation and review of account reconciliations. The temporary control procedures implemented in the third quarter of 2007 represent significant changes to our internal control over financial reporting.

The foregoing changes in controls will be incorporated into our Sarbanes-Oxley Section 404 annual assessment of internal control over financial reporting as of year end 2007. There have been no other 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 other than those described below.

*Failure to maintain effective internal control over financial reporting could adversely affect our financial results, our operations and our stock price, and cause investors to lose confidence in the reliability of our financial statements.*

Effective internal control over financial reporting is necessary for us to provide reliable financial reports. If we identify any deficiencies in our internal control over financial reporting such that there is a reasonable possibility that a material misstatement in our financial statements will not be prevented or detected on a timely basis, we would be unable to conclude, in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, that our internal control over financial reporting is effective. In such event, our financial results, operations and stock price could be adversely affected, and investors could lose confidence in the reliability of our financial statements.

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

On July 31, 2007, we issued 375 deferred common stock equivalents, or units, pursuant to provisions regarding dividends under the Amended and Restated Director Fee Plan to four non-employee directors. 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.

In August 2007, 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. As of September 30, 2007, the aggregate purchases pursuant to our share repurchase program totaled \$575.0 million. As of September 30, 2007, the remaining dollar value of shares that may yet be purchased under our share repurchase program was approximately \$189.0 million. Pursuant to the program, we repurchased shares of our common stock during the third quarter of 2007 as set forth in the table below.

<b>Period</b>	<b>Total number of shares purchased</b>	<b>Average price paid per share</b>	<b>Total number of shares purchased as part of publicly announced programs</b>	<b>Dollar value of shares that may yet be purchased under the programs</b>
July 1, 2007 – July 31, 2007	1,647,400	12.68	1,647,400	76,232,084
August 1, 2007 – August 31, 2007	3,268,834	11.85	3,268,834	237,491,030
September 1, 2007 – September 30, 2007	3,913,720	12.40	3,913,720	188,955,685
	8,829,954		8,829,954	

Subsequent to September 30, 2007, we repurchased 5,867,800 shares of common stock at an aggregate cost of \$79.4 million including commissions (average cost per share of \$13.54). After these events, the remaining dollar value of shares authorized to be purchased under our share repurchase program was approximately \$109.5 million.

**Item 6. Exhibits**

12.1 Ratio of earnings to fixed charges for the nine months ended September 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.

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- 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.

99.1 Form of Performance Unit Grant Award Agreement.

**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.

November 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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Index to Exhibits

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