SERVICE CORPORATION INTERNATIONAL
Form 10-K
March 01, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 1-6402-1
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 no.)*
1929 Allen Parkway **Houston, Texas** *(Address of principal executive offices)*	**77019** *(Zip code)*

Registrant s telephone number, including area code:
713/522-5141

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock ($1 par value)	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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 þ Accelerated Filer o Non-accelerated Filer o

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

The aggregate market value of the common stock held by non-affiliates of the registrant (assuming that the registrant s only affiliates are its officers and directors) was $2,236,208,053 based upon a closing market price of $8.14 on June 30, 2006 of a share of common stock as reported on the New York Stock Exchange Composite Transactions Tape.

The number of shares outstanding of the registrant s common stock as of February 20, 2007 was 293,476,937 (net of treasury shares)

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement in connection with its 2007 Annual Meeting of Shareholders (Part III)

SERVICE CORPORATION INTERNATIONAL

INDEX

Table of Contents

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 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.

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.

Table of Contents

PART I

Item 1. *Business.*

General

Service Corporation International (SCI) is North America s leading provider of deathcare products and services, with a network of funeral homes and cemeteries unequalled in geographic scale and reach. At December 31, 2006, we operated 1,613 funeral service locations and 452 cemeteries, (including 232 combination locations) in North America, which are geographically diversified across 45 states, eight Canadian provinces, the District of Columbia, and Puerto Rico. Our funeral segment also includes the operations of Kenyon International Emergency Services, a subsidiary that specializes in providing disaster management services in mass fatality incidents as well as training, planning, and Crisis Communications consulting services, and the operations of 14 funeral homes in Germany that we intend to exit when economic values and conditions are conducive to a sale. As part of the Alderwoods Group, Inc. (Alderwoods) transaction, we acquired an insurance business for which we have commenced a plan to divest. The operations of this business are presented as discontinued operations in our consolidated statement of operations and as assets and liabilities of discontinued operations in on our consolidated balance sheet. In addition, we own a minority interest in AKH Luxco, S.C.A., more commonly known as Pompes Funebres Génerales (PFG), France s leading provider of funeral services.

History

We were incorporated in Texas in July of 1962. Prior to 1999, we focused on the acquisition and consolidation of independent funeral homes and cemeteries in the fragmented deathcare industry in North America. During the 1990s, we also expanded our operations through acquisitions in Europe, Australia, South America; and the Pacific Rim. During the mid to late 1990s, acquisitions of deathcare facilities became extremely competitive resulting in increased prices for acquisitions and substantially reduced returns on invested capital. In 1999, we significantly reduced our level of acquisition activity and began to focus on identifying and addressing non-strategic or underperforming businesses.

This focus resulted in the divestiture of several North America and international operations beginning in 2001. During 2001 and 2002, we completed joint ventures of operations in Australia, the United Kingdom, Spain, and Portugal. In 2003, we sold our equity investment in our operations in Australia, Spain, and Portugal. During 2004, we sold our funeral operations in France and obtained a minority interest in the acquiring entity. We also sold our minority interest equity investment in the United Kingdom. During 2005, we divested of all of our operations in Argentina, Uruguay, and Chile. During 2006, we sold our funeral service location in Singapore, leaving our operations in Germany as our sole remaining funeral service locations outside of North America. We may pursue discussions with various third parties concerning the sale or joint venture of our operations in Germany.

In 2006, as part of our strategy to enhance our position as North America s premier funeral and cemetery provider, we acquired Alderwoods for $20.00 per share in cash. The purchase price of $1.2 billion includes the refinancing of $357.7 million and the assumption of $2.2 million of Alderwoods debt. Alderwoods properties, which include 578 funeral service locations, 70 cemeteries, and 63 combination locations, have been substantially integrated into our operations at December 31, 2006. These properties are operated in the same manner as our incumbent properties, under our leadership, and are reported in the appropriate reporting segment (funeral or cemetery) in our consolidated financial statements.

Funeral and Cemetery Operations

Worldwide, we have 1,627 funeral service locations and 452 cemeteries (including 232 combination locations) covering 45 states, eight Canadian provinces, the District of Columbia, Puerto Rico, and Germany. See Note 18 to the consolidated financial statements in Item 8 of this Form 10-K for financial information about our business segments and geographic areas.

Our funeral service and cemetery operations consist of funeral service locations, cemeteries, funeral service/cemetery combination locations, crematoria and related businesses. We provide all professional services relating to funerals and cremations, including the use of funeral facilities and motor vehicles, and preparation and embalming

Table of Contents

services. Funeral related merchandise, including caskets, burial vaults, cremation receptacles, flowers and other ancillary products and services, is sold at funeral service locations. Our 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, burial vaults, casket and cremation memorialization products, merchandise installations, and burial openings and closings. We also sell preneed funeral and cemetery preneed products and services whereby a customer contractually agrees to the terms of certain products and services to be delivered and performed in the future.

Funeral service/cemetery combination locations are those businesses in which a funeral service location is physically located within or adjoining a cemetery that we own. Certain combination locations consist of multiple cemeteries combined with one funeral home. Combination locations allow certain facility, personnel, and equipment costs to be shared between the funeral service location and cemetery. Such combination facilities typically can be cost competitive and have higher gross margins than if the funeral and cemetery operations were operated separately. Combination locations also create synergies between funeral and cemetery sales force personnel and give families added convenience to purchase both funeral and cemetery products and services at a single location. With the acquisition of Alderwoods, we acquired Rose Hills, which is the largest combination operation in the United States, performing approximately 5,000 calls and 9,000 interments per year.

Our operations in the United States and Canada are organized into 37 major markets and 45 middle markets (including eight Hispana markets). Each market is led by a market director with responsibility for funeral and/or cemetery operations and preneed sales. Within each market, the funeral homes and cemeteries share common resources such as personnel, preparation services, and vehicles. There are four market support centers in North America to assist market directors with financial, administrative, pricing, and human resource needs. These support centers are located in Houston, Miami, New York, and Los Angeles. The primary functions of the support centers are to help facilitate the execution of corporate strategies, coordinate communication between the field and corporate offices, and serve as liaisons for the implementation of policies and procedures.

The following table (which includes businesses held-for-sale at December 31, 2006) provides the number of our funeral homes, cemeteries, and combination locations by country, and by state, territory, or province:

Country, State/Territory/Province	**Number of Funeral Homes**	**Number of Cemeteries**	**Total**
United States			
Alabama	36	11	47
Alaska	3		3
Arizona	32	11	43
Arkansas	11	3	14
California	150	39	189
Colorado	27	12	39
Connecticut	18		18
District of Columbia	1		1
Florida	136	57	193
Georgia	51	21	72
Hawaii	2	2	4
Idaho	3	1	4

Illinois	48	31	79
Indiana	33	13	46
Iowa	7	4	11
Kansas	14	2	16
Kentucky	13	4	17
Louisiana	35	7	42
Maine	11		11

Country, State/Territory/Province	Number of Funeral Homes	Number of Cemeteries	Total
Maryland	13	8	21
Massachusetts	35	9	44
Michigan	29		29
Minnesota	10	2	12
Mississippi	30	6	36
Missouri	21	5	26
Montana	4		4
Nebraska	2		2
Nevada	3	1	4
New Hampshire	7		7
New Jersey	20		20
New Mexico	5		5
New York	91	1	92
North Carolina	56	16	72
Ohio	30	19	49
Oklahoma	27	7	34
Oregon	27	7	34
Pennsylvania	17	19	36
Puerto Rico	5	7	12
Rhode Island	4		4
South Carolina	13	12	25
Tennessee	56	19	75
Texas	172	52	224
Utah	3	3	6
Virginia	34	12	46
Washington	39	14	53
West Virginia	5	6	11
Wisconsin	8		8
Canada			
Alberta	26		26
British Columbia	36	6	42
Manitoba	5	3	8
New Brunswick	5		5
Nova Scotia	11		11
Ontario	48		48
Quebec	59		59
Saskatchewan	26		26
Germany	14		14
Total	1,627	452	2,079(1)

(1) Includes businesses held for sale at December 31, 2006.

We believe we have satisfactory title to the properties owned and used in our business, subject to various liens, encumbrances and easements, which are incidental to ownership rights and uses and do not materially detract from

Table of Contents

the value of the property. We also lease a number of facilities that we use in our business under both capital and operating leases.

At December 31, 2006, we owned approximately 88% of the real estate and buildings used at our facilities and the remainder of the facilities were leased. At December 31, 2006, our 452 cemeteries contained a total of approximately 32,366 acres, of which approximately 62% was developed.

A map of our locations in North America is presented below:

Competition

Although there are several public companies that own funeral homes and cemeteries, the majority of deathcare businesses are locally-owned, independent operations. We estimate that our funeral and cemetery market share (including a full year of Alderwoods operations) is approximately 14% based on industry revenue for 2005. The position of a single funeral home or cemetery in any community is a function of the name, reputation, and location of that funeral home or cemetery, although competitive pricing, professional service and attention, and well-maintained locations are also important.

We believe we have an unparalleled network of funeral service locations and cemeteries that offer high quality products and services at prices that are competitive with local competing funeral homes, cemeteries, and retail locations. Within this network, the funeral service locations and cemeteries operate under various names as most operations were acquired as existing businesses. We have branded our funeral operations in North America under the name Dignity Memorial®. We believe our national branding strategy gives us a strategic advantage and identity in the industry. While this branding process is intended to emphasize our seamless national network of funeral service locations and cemeteries, the original names associated with acquired operations, and their inherent goodwill and heritage, generally remain the same. For example, Geo. H. Lewis & Sons Funeral Directors is now Geo. H. Lewis & Sons Funeral Directors, a Dignity Memorial® provider.

Employees

At December 31, 2006, we employed 14,454 (14,411 in North America) individuals on a full time basis and 8,169 (8,165 in North America) individuals on a part time basis. Of the full time employees, 13,873 were employed in the funeral and cemetery operations and 581 were employed in corporate or other overhead activities and services. All eligible employees in the United States who so elect are covered by our group health and life insurance plans. Eligible employees in the United States are participants in retirement plans of SCI or various subsidiaries, while international employees are covered by other SCI (or SCI subsidiary) defined or government mandated benefit plans. Approximately 3.5% of our employees in North America are represented by unions. Although labor disputes are experienced from time to time, relations with employees are generally considered favorable.

Regulation

Our operations are subject to regulations, supervision and licensing under numerous foreign, federal, state and local laws, ordinances and regulations, including extensive regulations concerning trust funds, preneed sales of funeral and cemetery products and services and various other aspects of our business. We strive to comply in all material respects with the provisions of these laws, ordinances and regulations. Since 1984, we have operated in the United States under the Federal Trade Commission (FTC) comprehensive trade regulation rule for the funeral industry. The rule contains requirements for funeral industry practices, including extensive price and other affirmative disclosures and imposes mandatory itemization of funeral goods and services.

Other

Our corporate headquarters are located at 1929 Allen Parkway, Houston, Texas 77019. The property consists of approximately 127,000 square feet of office space and 185,000 square feet of parking space. We own and utilize three buildings located in Houston, Texas for corporate activities containing a total of approximately 238,000 square feet of office space. As a result of the acquisition of Alderwoods, we also lease approximately 71,000 square feet of office space located in Burnaby, British Columbia, which we expect to sublease during 2007.

We make available free of charge, on or through our website, our annual, quarterly and current reports and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission (SEC). Our website is http://www.sci-corp.com and our telephone number is (713) 522-5141. The SEC also maintains an internet site at http://www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically. The public may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

Each of our Board of Directors standing committee charters, our Corporate Governance Guidelines, our Code of Ethics for Board Members, and our Code of Conduct for Officers and Employees are available, free of charge, through our website or, upon request, in print. We will post on our internet website all waivers to or amendments of our Code of Conduct for Officers and Employees, which are required to be disclosed by applicable law and rules of the New York Stock Exchange listing standards. Information contained on our website is not part of this report.

Item 1A. *Risk Factors.*

Cautionary Statement on Forward-Looking Statements

The statements in this Form 10-K 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 uncert future events or outcomes. These statements are based on assumptions that we believe are reasonable; however, many important factors could cause our actual consolidated results in the future to differ materially from the forward-looking statements made herein and in any other documents or oral presentations made by, or on behalf of, the Company. These factors are discussed below. We assume no obligation to publicly update or revise any forward-looking statements made herein or any other forward-looking statements made by the Company, whether as a result of new information, future events or otherwise.

Our ability to execute our business plan depends on many factors, many of which are beyond our control.

Our strategic plan is focused on cost management and the development of key revenue initiatives designed to generate future internal growth in our core funeral and cemetery operations. Many of the factors necessary for the execution of our strategic plan, such as the number of deaths, are beyond our control. We cannot give assurance that we will be able to execute any or all of our strategic plan. Failure to execute any or all of the strategic plan could have a material adverse effect on our financial condition, results of operations, or cash flows.

We may fail to realize the anticipated benefits of the acquisition of Alderwoods.

The success of the acquisition of Alderwoods will depend, in part, on our ability to realize the anticipated cost savings from shared corporate and administrative areas, the rationalization of duplicative expenses, and the realization of revenue growth opportunities. However, to realize the anticipated benefits from the acquisition, we must successfully combine the businesses in a manner that permits those costs savings and revenue increases to be realized. If we are not able to successfully achieve these objectives, the anticipated benefits of the acquisition may not be realized fully or at all or may take longer or cost more to realize than expected. It is possible that the integration process could result in the loss of valuable employees, the disruption of ongoing businesses or inconsistencies in standards, controls, procedures, practices, and policies that could adversely impact our operations.

The integration of Alderwoods may prove disruptive and could result in the combined business failing to meet our expectations.

The process of integrating the operations of Alderwoods may require a disproportionate amount of resources and management attention. Our future operations and cash flow will depend largely upon our ability to operate the former Alderwoods locations efficiently, achieve the strategic operating objectives for our business and realize significant cost savings and synergies. Our management team may encounter unforeseen difficulties in managing the integration. In order to successfully combine and operate our businesses, our management team will need to focus on realizing anticipated synergies, revenue increases, and cost savings on a timely basis while maintaining the efficiency of our operations. Any substantial diversion of management attention or difficulties in operating the combined business could affect our revenues and ability to achieve operational, financial, and strategic objectives.

Our credit agreements and debt securities contain covenants that may prevent us from engaging in certain transactions.

Our credit agreements and debt securities contain, among other things, various affirmative and negative covenants that may prevent us from engaging in certain transactions that might otherwise be considered beneficial to us. These covenants limit, among other things, our and our subsidiaries ability to:

Incur additional secured indebtedness (including guarantee obligations);

Create liens on assets;

Engage in certain transactions with affiliates;

Enter into sale-leaseback transactions;

Engage in mergers, liquidations, and dissolutions;

Sell assets;

Enter into leases;

Pay dividends, distributions, and other payments in respect of capital stock and purchase our capital stock in the open market;

Make investments, loans, or advances;

Repay subordinated indebtedness or amend the agreements relating thereto;

Table of Contents

Change our fiscal year;

Create restrictions on our ability to receive distributions from subsidiaries; and

Change our lines of business.

Our bank credit facility also requires us to maintain certain leverage and interest coverage ratios. See Note 12 to the consolidated financial statements in Item 8 of this Form 10-K for further information related to our bank credit facility.

If we lost the ability to use surety bonding to support our preneed funeral and preneed cemetery activities, we could have to make material cash payments to fund certain trust funds.

We have entered into arrangements with certain surety companies whereby such companies agree to issue surety bonds on our behalf as financial assurance 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 issued to support our preneed funeral and cemetery activities. In the event all of the surety companies cancelled or did not renew our surety bonds, which are generally renewed for twelve-month periods, we would be required to either obtain replacement coverage or fund approximately $278.6 million as of December 31, 2006 into state-mandated trust accounts.

The funeral home and cemetery industry continues to be increasingly competitive.

In North America, the funeral and cemetery industry is characterized by a large number of locally owned, independent operations. To compete successfully, our funeral service locations and cemeteries must maintain good reputations and high professional standards in the industry, as well as offer attractive products and services at competitive prices. In addition, we must market the Company in such a manner as to distinguish us from our competitors. We have historically experienced price competition from independent funeral home and cemetery operators, monument dealers, casket retailers, low-cost funeral providers, and other non-traditional providers of services and merchandise. If we are unable to successfully compete, our financial condition, results of operations and cash flows could be materially adversely affected.

Our affiliated funeral and cemetery trust funds own investments in equity securities, fixed income securities and mutual funds, which are affected by financial market conditions that are beyond our control.

In connection with our preneed funeral and preneed cemetery merchandise and service sales, most affiliated funeral and cemetery trust funds own investments in equity securities and mutual funds. Our earnings and investment gains and losses on these equity securities and mutual funds are affected by financial market conditions that are beyond our control.

As of December 31, 2006, net unrealized appreciation in the preneed funeral and cemetery merchandise and services trust funds amounted to $24.0 million and $62.8 million, respectively. Our perpetual care trust funds had net unrealized appreciation of $39.6 million as of December 31, 2006. The following table summarizes the investment returns excluding fees on our trust funds for the last three years.

	2006	2005	2004

Preneed funeral trust funds	8.8%	6.6%	7.1%
Cemetery merchandise and services trust funds	8.4%	6.9%	6.7%
Perpetual care trust funds	10.8%	3.9%	8.6%

If earnings from our trust funds decline, we would likely experience a decline in future revenues. In addition, if the trust funds experienced significant investment losses, there could be insufficient funds in the trusts to cover the costs of delivering services and merchandise or maintaining cemeteries in the future. We would have to cover any such shortfall with cash flows from operations, which could have a material adverse effect on our financial condition, results of operations, or cash flows.

Increasing death benefits related to preneed funeral contracts funded through life insurance or annuity contracts may not cover future increases in the cost of providing a price guaranteed funeral service.

We sell price-guaranteed preneed funeral contracts through various programs providing for future funeral services at prices prevailing when the agreements are signed. For preneed funeral contracts funded through life insurance or annuity contracts, we receive in cash a general agency commission that typically averages approximately 16% of the total sale from the third party insurance company. Additionally, there is an increasing death benefit associated with the contract of approximately 1% per year to be received in cash at the time the funeral is performed. There is no guarantee that the increasing death benefit will cover future increases in the cost of providing a price-guaranteed funeral service, which could materially adversely affect our future cash flows, revenues, and operating margins.

Unfavorable results of litigation could have a material adverse impact on our financial statements.

As discussed in Note 15 to the consolidated financial statements in Item 8 of this Form 10-K, we are subject to a variety of claims and lawsuits in the ordinary course of our business. Adverse outcomes in some or all of the pending cases may result in significant monetary damages or injunctive relief against us. While management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse impact on our financial position or results of operations, litigation and other claims are subject to inherent uncertainties and management s view of these matters may change in the future. There exists the possibility of a material adverse impact on our financial position and the results of operations for the period in which the effect of an unfavorable final outcome becomes probable and reasonably estimable.

If the number of deaths in our markets declines, our cash flows and revenues may decrease.

If the number of deaths declines, the number of funeral services and interments performed by us could decrease and our financial condition, results of operations and cash flows could be materially adversely affected.

The continuing upward trend in the number of cremations performed in North America could result in lower revenue and gross profit dollars.

There is a continuing upward trend in the number of cremations performed in North America as an alternative to traditional funeral service dispositions. However, we have seen a recent reversal in the upward trend in our businesses as our strategic pricing initiative and discounting policies have resulted in a decline in highly-discounted, low-service cremation customers. In our operations in North America during 2006 and 2005, 40.9% of the comparable funeral services we performed were cremation cases compared to 39.6% performed in 2004, respectively. We expect this trend to continue in the near term. We also continue to expand our cremation memorialization products and services which has resulted in higher average sales for cremation services. If we are unable to successfully expand our cremation memorialization products and services, and cremations continue to be a significant percentage of our funeral services, our financial condition, results of operations, and cash flows could be materially adversely affected.

The funeral home and cemetery businesses are high fixed-cost businesses.

The majority of our operations are managed in groups called markets . Markets are geographical groups of funeral service locations and cemeteries that share common resources such as operating personnel, preparation services, clerical staff, motor vehicles and preneed sales personnel. Personnel costs, the largest of our operating expenses, are the cost components most beneficially affected by this grouping. We must incur many of these costs regardless of the number of funeral services or interments performed. Because we cannot necessarily decrease these costs when we experience lower sales volumes, a sales decline may cause margin percentages to decline at a greater rate than the decline in revenues.

Regulation and compliance could have a material adverse impact on our financial results.

Our operations are subject to regulation, supervision, and licensing under numerous foreign, federal, state, and local laws, ordinances and regulations, including extensive regulations concerning trust funds, preneed sales of funeral and cemetery products and services, and various other aspects of our business. The impact of such regulations varies depending on the location of our funeral and cemetery operations. Violations of applicable laws could result in fines or sanctions to us.

In addition, from time to time, governments and agencies propose to amend or add regulations, which would increase costs and decrease cash flows. For example, foreign, federal, state, local and other regulatory agencies have considered and may enact additional legislation or regulations that could affect the deathcare industry, such as regulations that require more liberal refund and cancellation policies for preneed sales of products and services, limit or eliminate our ability to use surety bonding, increase trust requirements, and/or prohibit the common ownership of funeral homes and cemeteries in the same market. If adopted by the regulatory authorities of the jurisdictions in which we operate, these and other possible proposals could have a material adverse effect on our financial condition, results of operations, and cash flows.

Compliance with laws, regulations, industry standards, and customs concerning burial procedures and the handling and care of human remains is critical to our continued success. Litigation and regulatory proceedings regarding these issues could have a material adverse effect on our financial condition, results of operations, and cash flows. We are continually monitoring and reviewing our operations in an effort to insure that we are in compliance with these laws, regulations, and standards and, where appropriate, taking appropriate corrective action.

A number of years may elapse before particular tax matters, for which we have established accruals, are audited and finally resolved.

The number of tax years with open tax audits varies depending on the tax jurisdiction. In the United States, the Internal Revenue Service is currently examining our tax returns for 1999 through 2004 and various state jurisdictions are auditing years through 2005. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, we believe that our accruals reflect the probable outcome of known tax contingencies. Unfavorable settlement of any particular issue would reduce a deferred tax asset or require the use of cash. Favorable resolution could result in reduced income tax expense reported in the financial statements in the future.

Item 1B. ***Unresolved Staff Comments.***

None.

Item 2. ***Properties.***

Information regarding properties is set forth in Item 1. Business of this Form 10-K.

Item 3. ***Legal Proceedings.***

Information regarding legal proceedings is set forth in Part II, Item 8. Financial Statements and Supplementary Data, Note 15.

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

None.

Table of Contents

EXECUTIVE OFFICERS OF THE COMPANY

The following table sets forth as of February 28, 2007 the name and age of each executive officer of the Company, the office held, and the year first elected an officer.

Officer Name	Age	Position	Year First Became Officer
R. L. Waltrip	76	Chairman of the Board	1962
Thomas L. Ryan	41	President and Chief Executive Officer	1999
Michael R. Webb	48	Executive Vice President and Chief Operating Officer	1998
J. Daniel Garrison	55	Senior Vice President Operations Support	1998
Philip Jacobs	52	Senior Vice President Chief Marketing Officer	2007
Stephen M. Mack	55	Senior Vice President Middle Market Operations	1998
James M. Shelger	57	Senior Vice President General Counsel and Secretary	1987
Eric D. Tanzberger	38	Senior Vice President Chief Financial Officer	2000
Sumner J. Waring, III	38	Senior Vice President Major Market Operations	2002
Jeffrey I. Beason	58	Vice President Corporate Controller	2006
Christopher H. Cruger	32	Vice President Business Development	2005
Jane D. Jones	51	Vice President Human Resources	2005
Albert R. Lohse	46	Vice President Litigation and Risk Management	2004
Harris E. Loring, III	56	Vice President and Treasurer	2006
Elisabeth G. Nash	45	Vice President Process and Technology	2004
Donald R. Robinson	49	Vice President Supply Chain Management	2005

Unless otherwise indicated below, the persons listed above have been executive officers or employees for more than five years.

Mr. Waltrip is the founder, Chairman of the Company, and a licensed funeral director. He grew up in his family s funeral business and assumed management of the firm in the 1950s after earning a Bachelor s degree in Business Administration from the University of Houston. He began buying additional funeral homes in the 1960s, achieving cost efficiencies by pooling their resources. At the end of 2006, the network he began had grown to include more than 2,000 funeral service locations and cemeteries. Mr. Waltrip took the Company public in 1969. He has provided leadership to the Company for over 40 years. In 2005, Mr. Waltrip resigned as Chief Executive Officer, but he continues to serve as Chairman of the Board.

Mr. Ryan joined the Company in June 1996 and served in a variety of financial management roles within the Company. In February 1999, Mr. Ryan was promoted to Vice President International Finance. In November 2000, he was promoted to Chief Executive Officer of European Operations based in Paris, France. In July 2002, Mr. Ryan was appointed President and Chief Operating Officer. In February 2005, he was promoted to Chief Executive Officer. Prior to joining the Company, Mr. Ryan was a Certified Public Accountant with Coopers & Lybrand L.L.P. for more than five years. Mr. Ryan is a Certified Public Accountant and holds a Bachelor of Business Administration degree from the University of Texas-Austin.

Mr. Webb joined the Company in 1991 when it acquired Arlington Corporation, a regional funeral and cemetery consolidator, where he was then Chief Financial Officer. Prior to joining Arlington Corporation, Mr. Webb held various executive financial and development roles at Days Inns of America and Telemundo Group, Inc. In 1993, Mr. Webb joined the Company s corporate development group, which he later led on a global basis before accepting operational responsibility for the Company s Australian and Hispanic businesses. Mr. Webb was promoted to Vice President International Corporate Development in February 1998 and was named Executive Vice President in July 2002. In February 2005, he was promoted to Chief Operating Officer. He is a graduate of the University of Georgia, where he earned a Bachelor of Business Administration degree.

Mr. Garrison joined the Company in 1978 and worked in a series of management positions until he was promoted to President of the Southeastern Region in 1992. In 1998, Mr. Garrison was promoted to Vice President International Operations. In 2000, Mr. Garrison became Vice President North American Cemetery Operations and was promoted to Vice President Operations Services in August 2002. He assumed his current position as Senior Vice President Operations Support in February 2005. Mr. Garrison has a Bachelor of Science degree in Administrative Management from Clemson University.

Mr. Jacobs joined SCI in 2007 as Senior Vice President and Chief Marketing Officer. Prior to joining the Company, Mr. Jacobs was employed by CompUSA as Chief Marketing Officer and held other management roles over the past 23 years at several of the nation s top advertising agencies, as well as client-side positions. Mr. Jacobs holds a Bachelor of Science degree from the University of Tennessee and a Masters degree from Vanderbilt University.

Mr. Mack joined the Company in 1973 as a resident director after graduating from Farmingdale State University of New York. He became Vice President of the Eastern Region in 1987 and in February 1998 Mr. Mack was appointed Vice President North American Funeral Operations. Mr. Mack was promoted to Senior Vice President Eastern Operations in August 2002 and assumed the office of Senior Vice President Middle Market Operations, his current position, in May 2004.

Mr. Shelger joined the Company in 1981 when it acquired IFS Industries, a regional funeral and cemetery consolidator, where he was then General Counsel. Mr. Shelger subsequently served as counsel for SCI s cemetery division until 1991, when he was appointed General Counsel. Mr. Shelger currently serves as Senior Vice President, General Counsel and Secretary of the Company. Mr. Shelger earned a Bachelor of Science degree in Business Administration from the University of Southern California in Los Angeles and a Juris Doctor from the California Western School of Law in San Diego.

Mr. Tanzberger joined the Company in August 1996 as Manager of Budgets & Financial Analysis. He was promoted to Vice President Investor Relations and Assistant Corporate Controller in January 2000 and to Corporate Controller in August 2002. In 2006, Mr. Tanzberger was promoted to the position of Senior Vice President and Chief Financial Officer. Prior to joining the Company, Mr. Tanzberger was Assistant Corporate Controller at Kirby Marine Transportation Corporation, an inland waterway barge and tanker company, from January through August 1996. Prior thereto, he was a Certified Public Accountant with Coopers & Lybrand L.L.P. for more than five years.
Mr. Tanzberger is a Certified Public Accountant and a graduate of the University of Notre Dame, where he earned a Bachelor of Business Administration degree.

Mr. Waring, a licensed funeral director, joined the Company as an Area Vice President in 1996 when the Company merged with his family s funeral business. Mr. Waring was appointed Regional President of the Northeast Region in 1999 and was promoted to Regional President of the Pacific Region in September 2001. Mr. Waring was promoted to Vice President Western Operations in August 2002 and assumed the office of Vice President Major Market Operations in November 2003. In February 2006, Mr. Waring was promoted to Senior Vice President Major Market Operations. Mr. Waring holds a Bachelor of Science degree in Business Administration from Stetson University in Deland, Florida, a degree in Mortuary Science from Mt. Ida College and a Masters of Business Administration degree from the University of Massachusetts Dartmouth.

Mr. Beason joined SCI in July 2006 as Vice President and Corporate Controller. Prior to joining SCI, he was an employee of El Paso Corporation, a natural gas transmission and production company. Mr. Beason joined El Paso in

1978 and held various accounting and reporting roles until 1993. From 1993 to 1996, he held the position of Sr. Vice President Administration of Mojave Pipeline Operating Company, a wholly owned subsidiary of El Paso Corporation. From 1996 to November 2005, Mr. Beason was Senior Vice President Controller and Chief Accounting Officer of El Paso Corporation. He is a Certified Public Accountant and holds a Bachelor of Business Administration in Accounting degree from Texas Tech University.

Mr. Cruger oversees Corporate Development, real estate, and the Dignity Memorial® affiliate network of independent funeral homes. He initially served the Company as a financial analyst in the corporate development department from 1996 until 1999, when he left to become Manager of Financial Analysis for R. H. Donnelley Corporation. During 2000, he returned to SCI to focus on international divestitures. From 2003 to February 2005, he served as Managing Director of Corporate Development. In February 2005, he was promoted to Vice President of Business Development. Mr. Cruger graduated from Lehigh University with a Bachelor of Science in Finance.

Mrs. Jones joined SCI in 2003 from Dynegy, Inc., where she served as Vice President of Total Rewards. She oversees human resources, training and education, and payroll and commission services activities that assist approximately 20,000 employees in North America. Mrs. Jones was promoted to Vice President Human Resources in February 2005. She holds a Bachelor of Business Administration degree in Accounting with a minor in Finance from Southern Methodist University. She is a Certified Compensation Professional and is active in professional organizations that include World at Work and the Society for Human Resources Management.

Mr. Lohse joined SCI in 2000 as Managing Director of Litigation and has since been involved in the resolution of major litigation issues for the Company. In 2004, Mr. Lohse was promoted to Vice President Corporate Governance. Before joining the Company, Mr. Lohse was Managing Partner at McDade, Fogler, Maines & Lohse where he conducted a general civil trial practice. Prior to that, he practiced tort and commercial litigation at Fulbright & Jaworski. Mr. Lohse received a Bachelor of Business Administration degree from the University of Texas and a Juris Doctor from the University of Houston Law Center.

Mr. Loring joined the Company in March 2000 as the Managing Director, Tax and was promoted to Assistant Treasurer in May 2004. Before joining the Company, Mr. Loring was Director, Tax at Stone & Webster, Inc. and held various corporate tax and treasury positions in other companies over a twenty-five year period. In February 2006, Mr. Loring was promoted to Vice President and Treasurer. Mr. Loring is a Certified Public Accountant and holds a Bachelor of Business Administration from Bryant College in North Smithfield, Rhode Island and a Master of Science in Taxation from Bentley College, Waltham, Massachusetts.

Ms. Nash joined SCI in 2002 as Managing Director of Strategic Planning and Process Improvement. Prior to joining SCI, Ms. Nash worked for the Pennzoil Corporation and held various senior management accounting and financial positions. In 2004, Ms. Nash was promoted to Vice President Continuous Process Improvement. Her primary responsibilities include improving operating systems, reducing overhead costs, and identifying and assisting in the implementation of initiatives to improve operating profit margins and cash flow. She is a graduate of Texas A&M University where she received a Bachelor of Business Administration degree in Accounting.

Mr. Robinson joined SCI in 1996 as Director of Procurement. Prior to joining the Company Mr. Robinson was employed by Marathon Oil Company, where he spent 16 years in a variety of procurement, logistics, and information technology positions. In February 2005, he was promoted to Vice President Supply Chain Management. Prior to this promotion, he was Managing Director of Business Support Services, a position in which he oversaw fleet management and office services; voice, travel, and shipping services; and supply chain and purchasing activities. Mr. Robinson holds a Bachelor of Science degree in Business Administration with a minor in Computer Service from Taylor University in Upland, Indiana.

Each officer of the Company is elected by the Board of Directors and holds their office until a successor is elected and qualified or until earlier death, resignation, or removal in the manner prescribed in the Bylaws of the Company. Each officer of a subsidiary of the Company is elected by the subsidiary s board of directors and holds their office until a successor is elected and qualified or until earlier death, resignation, or removal in the manner prescribed in the Bylaws of the Subsidiary.

15

PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***

Our common stock has been traded on the New York Stock Exchange since May 14, 1974. On December 31, 2006, there were 5,345 holders of record of our common stock. In calculating the number of shareholders, we consider clearing agencies and security position listings as one shareholder for each agency or listing. At December 31, 2006, we had 293,222,114 shares outstanding, net of 10,000 treasury shares.

During 2006, we paid cash dividends totaling $29.4 million and accrued $8.8 million for dividends paid on January 31, 2007. While we intend to pay regular quarterly cash dividends for the foreseeable future, all subsequent dividends are subject to final determination by our Board of Directors each quarter after its review of our financial performance.

The table below shows our quarterly high and low closing common stock prices for the two years ended December 31, 2006:

	2006		2005	
	High	**Low**	**High**	**Low**
First quarter	$ 8.46	$ 7.75	$ 7.83	$ 6.81
Second quarter	$ 8.50	$ 7.73	$ 8.02	$ 6.58
Third quarter	$ 9.34	$ 7.37	$ 8.85	$ 8.08
Fourth quarter	$ 10.45	$ 8.97	$ 8.61	$ 7.82

Options in our common stock are traded on the Philadelphia Stock Exchange. Our common stock is traded on the New York Stock Exchange under the symbol SCI.

For equity compensation plan information, see Part III of this Form 10-K.

On October 31, 2006, we issued 348 deferred common stock equivalents or units pursuant to provisions regarding the receipt of dividends under the Amended and Restated Director Fee Plan to four non-employee directors. These issuances were unregistered as they did not constitute a sale within the meaning of Section 2(3) of the Securities Act of 1933, as amended.

Since 2004, we have repurchased a total of $363.3 million of common stock at an average cost per share of $7.11. We did not repurchase any of our common stock during the three months ended December 31, 2006. At December 31, 2006, we had $36.0 million authorized for share repurchases. In February 2007, our Board of Directors approved an increase in our share repurchase program authorizing the investment of up to an additional $164 million to repurchase our common stock. We now have $200 million authorized by our Board of Directors for share repurchases. As discussed in Item 1A, our new credit agreement and debt securities contain covenants that restrict our ability to repurchase our common stock.

Table of Contents

Item 6. ***Selected Financial Data.***

The table below contains selected consolidated financial data for the years ended December 31, 2002 through December 31, 2006. The statement of operations data includes reclassifications of certain items to conform to current period presentations with no impact on net income or financial position.

The data set forth below should be read in conjunction with our consolidated financial statements and accompanying notes to the consolidated financial statements included in this Form 10-K. This historical information is not necessarily indicative of future results.

Selected Consolidated Financial Information

	Years Ended December 31,				
	2006(1)	**2005**	**2004**	**2003**	**2002**
	(Dollars in millions, except per share amounts)				
Selected Consolidated Statements of Operations Data:					
Revenue	$ 1,747.3	$ 1,711.0	$ 1,825.7	$ 2,308.9	$ 2,289.0
Income (loss) from continuing operations before cumulative effect of accounting changes	$ 52.6	$ 55.1	$ 117.4	$ 69.1	$ (91.5)
Income (loss) from discontinued operations, net of tax(2)	$ 3.9	$ 4.5	$ 43.8	$ 16.0	$ (8.4)
Cumulative effect of accounting changes, net of tax(3)(4)(5)(6)		$ (187.5)	$ (50.6)		$ (135.6)
Net income (loss)	$ 56.5	$ (127.9)	$ 110.7	$ 85.1	$ (235.4)
Earnings (loss) per share:					
Income (loss) from continuing operations before cumulative effect of accounting changes					
Basic	$ .18	$ .18	$ .37	$ .23	$ (.31)
Diluted	$ .18	$ .18	$ .36	$ .23	$ (.31)
Net income (loss)					
Basic	$ .19	$ (.42)	$ .35	$ .28	$ (.80)
Diluted	$ .19	$ (.42)	$ .34	$ .28	$ (.80)
Cash dividends declared per share	$ 0.105	$ 0.10	$	$	$
Selected Consolidated Balance Sheet Data (at December 31):					
Total assets	$ 9,729.4	$ 7,544.8	$ 8,227.2	$ 7,571.2	$ 7,801.8
Long-term debt (less current maturities), including capital leases	$ 1,912.7	$ 1,186.5	$ 1,200.4	$ 1,530.1	$ 1,885.2
Stockholders equity	$ 1,594.8	$ 1,581.6	$ 1,843.0	$ 1,516.3	$ 1,318.9
Selected Consolidated Statement of Cash Flows Data:					
Net cash provided by operating activities	$ 324.2	$ 312.9	$ 94.2	$ 374.3	$ 352.2

(1) Results for 2006 include operations acquired from Alderwoods from November 28, 2006 to December 31, 2006. These operations contributed $50.9 million to revenue, $5.4 million to net income and $8.6 million to net cash provided by operating activities during this period. For more information regarding the Alderwoods acquisition, see Part II, Item 8. Financial Statements and Supplementary Data, Note 5.

(2) Our operations in Singapore, which were sold in 2006 and in Argentina, Uruguay and Chile, which were sold in 2005 have been classified as discontinued operations for all periods presented. For more information regarding discontinued operations, see Part II, Item 8. Financial Statements and Supplementary Data, Note 21.

(3) Results for 2006 and 2005 reflect our change in accounting for direct selling costs related to preneed funeral and cemetery contracts. Results for 2005 include a $187.5 million charge, net of tax, for the cumulative effect of this change. For more information regarding this accounting change, see Part II, Item 8. Financial Statements and Supplementary Data, Note 3.

(4) On March 18, 2004, we implemented revised Financial Accounting Standards Board (FASB) Interpretation No. 46 (FIN 46R). Under the provisions of Financial Accounting Standards Board (FASB) Interpretation 46R (FIN 46R), we are required to consolidate our preneed funeral and cemetery merchandise and service trust assets, cemetery perpetual care trusts, and certain cemeteries. As a result of this accounting change, we recognized a cumulative effect charge of $14.0 million, net of tax, in 2004.

(5) Results for 2004, 2005, and 2006 reflect our change in accounting for pension gains and losses. Results for 2004 include a $36.6 million charge, net of tax, for the cumulative effect of this change.

(6) Results for all periods presented reflect our change in accounting for goodwill under Statement of Financial Accounting Standard (SFAS No. 142), *Goodwill and Other Intangible Assets* (SFAS 152). Results for 2002 include a $135.6 million charge, net of tax, for the cumulative effect of this change.

Item 7. *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. During 2006, we accomplished several key goals that we believe will position us for continued growth in 2007.

In November 2006, we acquired Alderwoods for $20.00 per share in cash, resulting in a purchase price of $1.2 billion, which includes the refinancing of $357.7 million and the assumption of $2.2 million of Alderwoods debt. The following table sets forth the sources and uses of funds related to the Alderwoods acquisition:

		(In millions)
Sources		
Cash on Hand	$	608
Term Loan		150
Private Placement Notes		200
Senior Notes		500
		1,458
Uses		
Purchase Alderwoods equity		861
Repay Alderwoods debt		358(1)
Repay SCI debt		139
Debt Costs		27
Transaction Cost		73

1,458

(1) Simultaneously with the transaction close, Alderwoods repaid their existing indebtedness with funds advanced from us. We assumed a remaining debt balance of approximately $2 million.

The acquisition of Alderwoods allows us to serve a number of new, complementary areas, while enabling us to capitalize on significant synergies and operating efficiencies. The acquisition provides, among other things:

Increased scale. The acquisition combines the two largest deathcare companies in North America, creating a network of funeral homes and cemeteries across 45 states, eight Canadian provinces, the District of Columbia, and Puerto Rico;

Compelling synergies. We have identified several areas where cost-saving synergies can be reasonably and quickly realized, including 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. Excluding one-time cash integration costs of $39 million expected in 2007, we expect to achieve annual pretax cost savings and revenue enhancements totaling $90 million to $100 million within eighteen months of closing the acquisition; and

Quickly materializing benefits. Former Alderwoods operations contributed $8.9 million from continuing operations before income tax and $8.6 million in cash flow from operations from November 28, 2006 (the acquisition date) to December 31, 2006.

Since August 2004, we have invested more than $360 million in repurchasing our stock, and we have paid a quarterly cash dividend since early 2005. We currently have over $200 million authorized to repurchase our common stock. Our financial stability is further enhanced by our $6.5 billion backlog of future revenues at December 31, 2006, 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.

We believe customer attitudes and preferences are essential to our business. We are replacing the industry s traditional one-size-fits-all service approach with a flexible operating and marketing strategy that categorizes customers according to personal needs and preferences. Using this new approach, we are tailoring our product and service offerings based on four variables:

quality and prestige,

religious and ethnic customs,

convenience and location, and

price.

By identifying customers based on these variables, we can focus our resources on the most profitable customer categories and improve our marketing effectiveness. We continue to refine our pricing, product and marketing strategies to support this approach.

Consistent with this strategy, we have begun to analyze existing business relationships to determine whether they align with our strategic goals. As a result, we made certain local business decisions to exit unprofitable business relationships and activities in 2005 and 2006, which resulted in an initial decrease in the number of total funeral services performed. However, we also experienced significant improvements in both average revenue per funeral service and gross margins. We expect these improvements to continue into the future as we redeploy resources to more profitable areas. We continue to analyze our existing operations, including those newly acquired in the Alderwoods acquisition, and may exit certain business relationships or activities that do not fit our customer segmentation strategy.

Realign pricing to reflect current market environment.

We, along with our competitors in the deathcare industry, have historically generated most of our profits from the sale of traditional products (including caskets, vaults, and markers), while placing less emphasis on the services involved in funeral and burial preparation. However, due to increased customer preference for comprehensive and personalized deathcare services, as well as increased competition from retail outlets (including on-line retailers) for the sale of traditional products, we have realigned our pricing strategy from product to service offerings in order to focus on services that are most valued by customers. Our initial results from the realignment strategy have been favorable based on increases in the overall average revenue per funeral service performed. We are currently evaluating the pricing of those locations acquired from Alderwoods and expect to make adjustments in the future to similarly align the pricing strategy for these locations as well.

Drive operating discipline and take advantage of our scale.

Although we have already made substantial improvements in our infrastructure, we believe we can continue to achieve operating improvements through centralization and standardization of processes for staffing, central care, fleet management and cemetery maintenance. The acquisition of Alderwoods provides further opportunities for synergies and operating efficiencies, which will allow us to utilize our scale and increase profitability. We are developing clear, yet flexible, operating standards that will be used as benchmarks for productivity in these areas. In conjunction with these standards, we will develop and track shared best practices to support higher productivity. We also intend to continue to capitalize on our nationwide network of properties by pursuing strategic affinity partnerships. Over the longer term, we believe these relationships can be important to potential customers in their funeral home selection process.

Manage and grow the footprint.

We are beginning to manage our network of business locations by positioning each business location to support the preferences of its local customer base while monitoring each market for changing demographics and competitive dynamics. We will primarily target customers who value quality and prestige or adhere to specific religious or ethnic customs. In addition, we expect to pursue selective business expansion through construction or targeted acquisitions of cemeteries and funeral homes with a focus on the highest return customer categories. In particular, we will focus cemetery expansion efforts on large cemeteries that are or may be combined with funeral home operations, which would allow facility, personnel, and equipment costs to be shared between the funeral service location and the cemetery.

Financial Condition, Liquidity and Capital Resources

Capital Allocation Considerations

Since 1999, we have gained significant financial flexibility by reducing debt and improving our cash flow. We rely on cash flow from operations as a significant source of liquidity. Our cash flow from operating activities provided $324 million in 2006 and we expect our operating cash flow in 2007 to range from $306 million to $346 million. Our current cash balance is $63 million as of February 23, 2007. In 2007, we expect to generate between $150 million and $170 million in proceeds from divestitures of FTC-mandated properties and other SCI properties already identified for disposal. In addition, we have approximately $240 million in borrowing capacity under our 5-year revolving credit facility (which is currently supporting $61.1 million of letters of credit). We have no significant scheduled debt maturities due in 2007. We believe these sources of liquidity can be supplemented by our ability to access the capital markets for additional debt or equity securities.

In order to finance the Alderwoods acquisition, we significantly increased our indebtedness in the fourth quarter of 2006. In addition to using $608 million of cash on hand, we issued $500 million in Senior Notes, $200 million in privately placed debt securities, and took out a $150 million term loan for up to three years under our new credit facility. We prepaid $50 million of our term loan indebtedness in December 2006 and prepaid an additional $60 million in January 2007. At December 31, 2006, our current liabilities exceeded our current assets as a result of using $608 million of available cash in the Alderwoods transaction. We believe our future operating cash flows and the available capacity under our new credit facility described above will be adequate to meet our working capital needs.

During 2006, and as of February 23, 2007, we had the following issuances and repayments of our debt:

Issuances

Type	Interest Rate	Principal(1) (In millions)	Due Date
Senior Notes	7.375%	$ 250	2014
Senior Notes	7.625%	250	2018
Senior Notes Series A	Libor + 2.0%	50	2011
Senior Notes Series B	Libor + 2.0%	150	2011
Term Loan		150	2009
Issuances through December 31, 2006		$ 850	
Repayments normal retirements			
Notes	7.2%	$ 11	2006
Other	various	15	various
Repayments through December 31, 2006		$ 26	
Repayments early extinguishment			
Notes	7.7%	$ 139	2009
Term Loan		50	2009

Repayment through December 31, 2006		189
Term Loan		60
Repayments through February 23, 2007	$	249

We will continue to focus on funding growth initiatives that generate increased profitability, revenue, and cash flows. These capital investments include the construction of high-end cemetery property (such as private family estates) and the construction of funeral home facilities at existing cemeteries. We will also consider the acquisition of additional deathcare operations that fit our long-term customer-focused strategy, if the expected returns will exceed our cost of capital.

Since early 2005, we have paid shareholders a quarterly cash dividend of $0.025 per common share. In November 2006, we increased our dividend to $0.03 per common share. While we intend to pay regular quarterly cash dividends for the foreseeable future, all future dividends are subject to final determination by our Board of Directors each quarter after its review of our financial performance.

We currently have approximately $200 million authorized under our share repurchase program. Once we achieve our internal capital structure and bank covenant targets, we intend to make purchases from time to time in the open market or through privately negotiated transactions, subject to market conditions, debt covenants and normal trading restrictions. Our credit agreement and privately-placed debt securities contain covenants that limit our ability to repurchase our common stock. There can be no assurance that we will buy our common stock under our share repurchase program in the future.

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 year ended December 31, 2006 compared to 2005 and 2004 are as follows:

Operating Activities Cash flows from operating activities was $324.2 million in 2006 compared to $312.9 million in 2005. The 2005 cash flows from operating activities increased by $218.7 million as compared to the operating cash flows in 2004. Included in 2006 are transition costs related to the Alderwoods acquisition of $3.2 million and legal payments of $5.7 million. Included in 2005 was a federal income tax refund of $29.0 million. Included in 2004 was the payment of $131.1 million related to the resolution of certain litigation matters, a $20.0 million voluntary cash contribution to our pension plan, and the payment of $11.4 million to retire life insurance policy loans related to our SERP and Senior SERP retirement programs.

Excluding the above items, cash flow from operations in 2006 increased approximately $50.0 million compared to 2005. This increase is primarily due to $21.2 million of rent payments that were classified in operating cash flows in 2005, but which are classified as principal payments on capital leases in cash flows from financing activities in 2006 due to our revised lease terms. The remaining increase is a result of $10.9 million in proceeds from the redemption of convertible preferred equity certificates received in connection with our disposition of our operations in France, the receipt of $7.9 million of endowment care proceeds as a result of the resolution of disputes over ownership rights, and a source of approximately $10.0 million from working capital. This working capital source resulted from an increase in preneed and atneed cash receipts, and increases in cash interest income, which were partially offset by an increase in bonus and long-term incentive compensation payments in 2006 related to a 2003 compensation program.

In addition to the items discussed above, the increase in operating cash flows in 2005 as compared to 2004 is the result of an extra bi-weekly cash payroll payment of approximately $19.0 million in 2004, approximately $13.0 million decrease in bonus payments, an increase in net trust withdrawals, and a $16.7 million decrease in cash interest paid. These net sources of cash were partially offset by cash outflows of $16.0 million associated with our cash funding of our 401(k) matches in 2005 (compared with funding through the use of stock in 2004) and a $10.2 million increase in cash outflows to improve internal controls in order to comply with Section 404 of the Sarbanes-Oxley Act. Cash receipts from Kenyon increased $15.0 million (offset by an $18.8 million increase in Kenyon expenses) in 2005 compared to the same period in 2004 due to Kenyon s involvement with the incidents in Asia, Greece and the U.S. gulf coast. Additionally, cash flows from operating activities provided by our former operations in France decreased $18.3 million in 2005 as a result of the sale of our French operations in March 2004.

We did not pay federal income taxes in 2006, 2005 or 2004. Because of our net operating loss carryforwards we do not expect to pay federal income taxes until the second half of 2007. Foreign, state and local income tax payments increased $9.0 million to $15.6 million in 2006 as compared to $6.6 million in 2005 and $10.8 million in 2004 primarily as a result of lower foreign taxes paid due to the disposition of some of our operations in 2004.

Investing Activities Cash flows from investing activities declined $1.5 billion in 2006 compared to 2005 due to $1.3 billion in cash outflows for acquisitions (primarily Alderwoods) and a $180.0 million decrease in proceeds from divestitures. The 2005 cash flows from investing activities of $171.0 million decreased by

$118.5 million primarily due to Alderwoods, as compared to the investing cash flows in 2004. This decline was driven by a decrease in proceeds from divestitures and a decrease in net withdrawals from restricted funds primarily related to various commercial commitments.

In 2006, we acquired Alderwoods for $1.2 billion, including refinancing of $357.7 million of Alderwoods debt. We also received $11.0 million of proceeds held as an income tax receivable related to the 2005 sale of our operations in Chile and $10.6 million in cash proceeds from the fourth quarter 2006 sale of our operations in Singapore.

In 2005, we received $90.4 million from the disposition of our cemetery operations in Chile, $42.7 million related to the collection of the EUR 10 million note receivable and the redemption of preferred equity certificates related to our equity investment in our former French operations (of which $39.7 million is reported as an investing activity), and $21.6 million from the disposition of our Argentina and Uruguay businesses.

In 2004, we sold our funeral operations in France and received net cash proceeds of $281.7 million. Following a successful public offering transaction of our former United Kingdom affiliate during the second quarter of 2004, we liquidated our debt and equity holdings in this affiliate and collected $53.8 million in aggregate, of which $49.2 million is reported as an investing activity.

Financing Activities Cash flows from financing activities generated $565.2 million in 2006 compared to using $326.4 million in 2005. This $891.6 million net increase in cash was driven by proceeds from the issuance of long-term debt, a reduction in share repurchases, and a reduction in debt payments. Cash used in financing activities decreased $9.6 million in 2005 compared to 2004 primarily due to stock repurchases, partially offset by debt extinguishments and dividend payments.

Proceeds from long-term debt (net of debt issuance costs) were $825.3 million in 2006 due to the issuance of $250.0 million of senior unsecured 7.625% notes due in 2018, $250.0 million of senior unsecured 7.375% notes due 2014, $200 million of private placement offerings, and $150 million term loan. Proceeds from the issuance of debt were $291.5 million in 2005 due to the issuance of senior unsecured 7.00% notes due in 2017. In 2004, proceeds of $241.4 million were due to the issuance of 6.75% notes due 2016.

Payments of debt in 2006 were $228.9 million due to the acceptance of the tender of $139.0 million of our 7.70% senior notes due 2009, a $50.0 million repayment of our new term loan, $26.1 million in scheduled debt payments, and $21.3 million in payments on capital leases. The $377.1 million of debt payments in 2005 were related to early extinguishments of $291.3 million, the $63.5 million final payment of 6.00% notes due December 2005 and $14.5 million of other note payments. In 2004, payments of debt were $477.8 million due to the $300.0 million early extinguishment, the repayment of $111.2 million of the 7.375% notes due 2004 and $50.8 million of 8.375% notes due in 2004.

We repurchased 3.4 million shares of common stock for $27.9 million in 2006, compared to 31.0 million shares for $225.1 million in 2005 and 16.7 million shares for $110.3 million in 2004.

We paid $29.4 million of cash dividends during 2006 and $22.6 million of cash dividends during 2005 related to the quarterly cash dividend reinstated in 2005 by the Board of Directors. There were no dividend payments in 2004.

Off-Balance Sheet Arrangements, Contractual Obligations, and 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, such as debt maturities, interest on long-term debt, and employment, consulting and non-competition agreements. 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.

Table of Contents

The following table details our known future cash payments (on an undiscounted basis) related to various contractual obligations as of December 31, 2006.

	Payments Due by Period				
Contractual Obligations	**2007**	**2008 - 2009**	**2010 - 2011**	**Thereafter**	**Total**
	(Dollars in millions)				
Long-term debt maturities(1)	46.2	535.6	248.4	1,128.7	1,958.9
Interest obligation on long-term debt	141.1	267.1	225.5	549.7	1,183.4
Operating lease agreements(2)	8.3	14.4	10.2	42.0	74.9
Employment, consulting and non-competition agreements(3)	16.9	12.0	3.1	3.7	35.7
Pension termination(4)	40.0				40.0
Total contractual obligations	$ 252.5	$ 829.1	$ 487.2	$ 1,724.1	$ 3,292.9

(1) Our outstanding indebtedness contains standard provisions, such as payment delinquency default clauses and change of control clauses. In addition, our bank credit agreement contains a maximum leverage ratio and a minimum interest coverage ratio. See Part II, Item 8. Financial Statements and Supplementary Data, Note 12 for additional details of our long-term debt.

(2) The majority of our lease arrangements contain options to (i) purchase the property at fair value on the exercise date, (ii) purchase the property for a value determined at the inception of the leases, or (iii) renew for the fair rental value at the end of the primary lease term. Our leases primarily relate to funeral service locations and cemetery operating and maintenance equipment. See Part II, Item 8. Financial Statements and Supplementary Data, Note 15 for additional details related to leases.

(3) We have entered into management employment, consulting and non-competition agreements which contractually require us to make cash payments over the contractual period. The agreements have been primarily entered into with certain officers and employees and former owners of businesses acquired. Agreements with contractual periods less than one year are excluded. See Part II, Item 8. Financial Statements and Supplementary Data, Note 15 for additional details related to these agreements.

(4) We have committed to a plan to terminate our Cash Balance Plan and certain other pension plans in 2007. See Part II, Item 8. Financial Statements and Supplementary Data, Note 17 for additional details related to our pension plans.

The following table details our known potential or possible future cash payments (on an undiscounted basis) related to various commercial and contingent obligations as of December 31, 2006.

	Expiration by Period		
Commercial and Contingent Obligations	**2007**	**Thereafter**	**Total**

		2008 - 2009	**2010 - 2011**		
		(Dollars in millions)			
Surety obligations(1)	$ 278.6	$	$	$	$ 278.6
Letters of credit(2)	61.1				61.1
Representations and warranties(3)	9.0	23.8			32.8
Income distributions from trust(4)	15.2				15.2
Total commercial and contingent obligations	$ 363.9	$ 23.8	$	$	$ 387.7

(1) See the section titled Financial Assurances following this table in this Form 10-K.

(2) We are occasionally required to post letters of credit, issued by a financial institution, to secure certain insurance programs or other obligations. Letters of credit generally authorize the financial institution to make a payment to the beneficiary upon the satisfaction of a certain event or the failure to satisfy an obligation. The letters of credit are generally posted for one-year terms and are usually automatically renewed upon maturity until such time as we have satisfied the commitment secured by the letter of credit. We are obligated to

reimburse the issuer only if the beneficiary collects on the letter of credit. We believe that it is unlikely we will be required to fund a claim under our outstanding letters of credit. As of December 31, 2006, the full amount of the letters of credit was supported by our credit facility which expires November 2011.

(3) In addition to the letters of credit described above, we currently have contingent obligations of $32.8 million related to our asset sales and joint venture transactions. We have agreed to guarantee certain representations and warranties associated with such disposition transactions with letters of credit or interest-bearing cash investments. We have interest-bearing cash investments of $9.0 million included in *Deferred charges and other assets* pledged as collateral for certain of these contingent obligations. We do not believe we will ultimately be required to fund to third parties any claims against these representations and warranties. During the year ended December 31, 2004, we recognized $35.8 million of contractual obligations related to representations and warranties associated with the disposition of our funeral operations in France. The remaining obligations of $23.8 million at December 31, 2006 are primarily related to certain foreign taxes and certain litigation matters. This amount is recorded in *Other liabilities* in our consolidated balance sheet. See Part II, Item 8. Financial Statements and Supplementary Data, Note 15 for additional information related to this obligation.

(4) In certain states and provinces, we have withdrawn allowable distributable earnings including unrealized gains prior to the maturity or cancellation of the related contract. In the event of market declines, we may be required to re-deposit portions or all of these amounts into the respective trusts in some future period.

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. The obligations underlying these surety bonds are recorded on the 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.

	December 31, 2006	December 31, 2005
	(Dollars in millions)	
Preneed funeral	$ 137.0	$ 139.3
Preneed cemetery:		
Merchandise and services	162.0	161.8
Pre-construction	8.6	12.5
Bonds supporting preneed funeral and cemetery obligations	307.6	313.6
Bonds supporting preneed business permits	3.6	4.7
Other bonds	12.4	11.0
Total surety bonds outstanding	$ 323.6	$ 329.3

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 years ended December 31, 2006 and 2005, we had $50.9 million and $64.0 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 the end of 2006 and 2005.

Trust-Funded Preneed Funeral and Cemetery Contracts: The funds deposited into trust (in accordance with various state and provincial laws) are invested by independent trustees in accordance with the investment guidelines established by statute or, where the prudent investor rule is applicable, the guidelines established by the Investment Committee of our Board of Directors. We retain any funds above the amounts required to be deposited into trust accounts and use them for working capital purposes, generally to offset the selling and administrative costs of the preneed programs.

Investment earnings associated with the trust investments are expected to mitigate the inflationary costs of providing the preneed funeral and cemetery services and merchandise in the future for the prices that were guaranteed at the time of sale. The preneed funeral and cemetery trust assets are consolidated and recorded in our consolidated balance sheet at market value. Investment earnings on trust assets are generally accumulated in the trust and distributed as the revenue associated with the preneed funeral or cemetery contract is recognized or cancelled by the customer. In certain states and provinces, the trusts are allowed to distribute a portion of the investment earnings to us prior to that date.

If a preneed funeral or cemetery contract is cancelled prior to delivery, state or provincial law determines the amount of the refund owed to the customer, if any, including the amount of the attributed investment earnings. Upon cancellation, we receive the amount of principal deposited to trust and previously undistributed net investment earnings and, where required, issue a refund to the customer. We retain excess funds, if any, and recognize the attributed investment earnings (net of any investment earnings payable to the customer) as revenue in our consolidated statement of operations. In certain jurisdictions, we may be obligated to fund any shortfall if the amounts deposited by the customer exceed the funds in trust. Based on our historical experience, we have included a cancellation reserve for preneed funeral and cemetery contracts in our consolidated balance sheet of $151.3 million and $112.0 million as of December 31, 2006 and 2005, respectively.

The cash flow activity over the life of a trust funded preneed funeral or cemetery contract from the date of sale to its recognition or cancellation is captured in the operating cash flow line items *(Increase) decrease in preneed receivables and trust investments, Increase (decrease) in deferred preneed revenue, Increase (decrease) in non-controlling interest* and *Net income (loss)* in the consolidated statement of cash flows. While the contract is outstanding, cash flow is provided by the amount retained from funds collected from the customer and any distributed investment earnings. Prior to January 1, 2005, this amount was reduced by the payment of preneed deferred selling costs. The effect of amortizing preneed deferred selling costs was reflected in *Depreciation and amortization* in the consolidated statement of cash flows. Effective January 1, 2005, the payment of direct selling costs associated with trust funded preneed contracts is reflected in the consolidated statement of cash flows as cash flows from operating activities in the line item *Net income (loss)*, since such direct selling costs are expensed as incurred. At the time of death maturity, we receive the principal and undistributed investment earnings from the funeral trust and any remaining receivable due from the customer. At the time of delivery or storage of cemetery merchandise and service items for which we were required to deposit funds to trust, we receive the principal and undistributed investment earnings from the cemetery trust. There is generally no remaining receivable due from the customer, as our policy is to deliver preneed cemetery merchandise and service items only upon payment of the contract balance in full. This cash flow at the time of service, delivery or storage is generally less than the associated revenue recognized, thus reducing cash flow from operating activities.

The tables below detail our North America results of preneed funeral and cemetery production and maturities, excluding insurance contracts, for the years ended December 31, 2006 and 2005.

	North America Years Ended December 31, 2006	2005
	(Dollars in millions)	
Funeral:		
Preneed trust-funded (including bonded):		
Sales production	$ 121.9	$ 131.9
Sales production (number of contracts)	27,062	35,490
Maturities	$ 166.9	$ 160.9
Maturities (number of contracts)	40,813	40,368
Cemetery:		
Sales production:		
Preneed	$ 308.0	$ 307.4
Atneed	219.8	210.5
Total sales production	527.8	517.9
Sales production deferred to backlog:		
Preneed	$ 146.9	$ 151.3
Atneed	164.3	156.9
Total sales production deferred to backlog	311.2	308.2
Revenue recognized from backlog:		
Preneed	$ 143.5	$ 138.6
Atneed	162.3	157.1
Total revenue recognized from backlog	327.3	295.7

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. These general agency commissions (GA revenues) are based on a percentage per contract sold and are recognized as funeral revenues when the insurance purchase transaction between the customer and third-party insurance provider is completed. Direct selling costs incurred pursuant to the sale of insurance-funded preneed funeral contracts are expensed as incurred. 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 consolidated balance sheet. Approximately 60% of our North America preneed funeral production in 2006 relates to insurance-funded preneed funeral contracts.

The third-party insurance company collects funds related to the insurance contract directly from the customer. The life insurance contracts include a death benefit escalation provision, which is expected to offset the inflationary costs of providing the preneed funeral services and merchandise in the future at the prices that were guaranteed at the time of the preneed sale. The customer/policy holder assigns the policy benefits to our funeral home to pay for the preneed funeral contract at the time of need.

Table of Contents

Additionally, we may receive cash overrides based on achieving certain dollar volume targets of life insurance policies sold as a result of marketing agreements entered into in connection with the sale of our insurance subsidiaries in 2000.

The table below details the North America results of insurance-funded preneed funeral production and maturities for the years ended December 31, 2006 and 2005, and the number of contracts associated with those transactions.

	North America Years Ended December 31, 2006	North America Years Ended December 31, 2005
	(Dollars in millions)	
Preneed funeral insurance-funded(1):		
Sales production	$ 192.1	$ 193.4
Sales production (number of contracts)	36,152	42,221
General agency revenue	$ 29.9	$ 27.6
Maturities	$ 192.9	$ 194.0
Maturities (number of contracts)	42,022	41,640

(1) Amounts are not included in the 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 December 31, 2006 and 2005. Additionally, the table reflects our North America backlog of unfulfilled insurance-funded contracts (which was not included in our consolidated balance sheet) at December 31, 2006 and 2005. The backlog amounts presented are reduced by an amount that we believe will cancel before maturity based on historical experience.

Table of Contents

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.

	North America			
	2006		2005	
	Market	Cost	Market	Cost
	(Dollars in millions)			
Backlog of trust-funded deferred preneed funeral revenues	$ 1,658.1	$ 1,633.5	$ 1,495.5	$ 1,482.6
Backlog of insurance-funded preneed funeral revenues	$ 2,982.0	$ 2,982.0	$ 2,092.1	$ 2,092.1
Total backlog of preneed funeral revenues	$ 4,640.1	$ 4,615.5	$ 3,587.6	$ 3,574.7
Assets associated with backlog of trust-funded deferred preneed funeral revenues, net of estimated allowance for cancellation	$ 1,445.0	$ 1,420.4	$ 1,158.7	$ 1,145.9
Insurance policies associated with insurance-funded deferred preneed funeral revenues, net of estimated allowance for cancellation	$ 2,982.0	$ 2,982.0	$ 2,092.1	$ 2,092.1
Total assets associated with backlog of preneed funeral revenues	$ 4,427.0	$ 4,402.4	$ 3,250.8	$ 3,238.0
Backlog of deferred cemetery revenues	$ 1,853.0	$ 1,790.1	$ 1,644.5	$ 1,600.5
Assets associated with backlog of deferred cemetery revenues, net of estimated allowance for cancellation	$ 1,357.5	$ 1,334.5	$ 1,157.4	$ 1,119.3

The market value of funeral and cemetery trust investments was based primarily on quoted market prices at December 31, 2006 and 2005. 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 Years Ended December 31, 2006, 2005, and 2004

Management Summary

Our primary financial focus in 2006 was on funding disciplined growth initiatives that generate increased profitability and cash flow margins. The most significant of these initiatives was the acquisition of Alderwoods in the fourth quarter of 2006. Former Alderwoods businesses contributed $11 million of income from continuing operations before income tax representing their operations from November 28, 2006 (the acquisition date) through December 31, 2006. Other key highlights in 2006 included:

- an improvement in 2006 gross margin percentage to 19.7% from 17.4% in 2005;

- a 9.0% increase in North America comparable average revenue per funeral service (7.9% excluding a floral revenue increase) compared to 2005, which more than offset a 5.8% decline in North America comparable funeral services performed;

Table of Contents

- North America comparable cemetery revenue increased $32.5 million, or 6.1%, in 2006 compared to 2005; and
- Cremation rates were 40.9% in 2006 and 2005 reflecting our strategic pricing initiative and discounting policies, which have resulted in a decline in highly-discounted, low-service cremation customers.

Results of Operations

In 2006, we reported consolidated net income of $56.5 million ($.19 per dilutive share) compared to a net loss in 2005 of $127.9 million ($(.42) per dilutive share) and net income in 2004 of $110.7 million ($.34 per dilutive share). These results were impacted by large non-recurring items that decreased earnings, including:

- after-tax accounting changes of $187.5 million in 2005 and $50.6 million in 2004;
- net after-tax losses on asset sales of $50.1 million in 2006 and $31.2 million in 2005;
- after-tax losses from the early extinguishment of debt of $10.7 million in 2006, $9.3 million in 2005, and $10.5 million in 2004;
- after-tax expenses related to our acquisition of Alderwoods of $4.3 million in 2006;
- after-tax expenses related to our Bridge Financing of $3.9 million in 2006; and
- after-tax settlement of significant litigation matters of $38.7 million in 2004.

Significant non-recurring items that increased earnings included:

- state net operating loss tax benefits of $11.9 million and $7.9 million in 2005 and 2004, respectively;
- after-tax earnings from discontinued operations of $3.9 million in 2006, $4.5 million in 2005, and $43.8 million in 2004; and
- after-tax gain from the sale of assets of $53.2 million in 2004.

Table of Contents

Consolidated Versus Comparable Results Years Ended December 31, 2006, 2005, and 2004

The table below reconciles our consolidated GAAP results to our comparable, or same store, results for the years ended December 31, 2006, 2005 and 2004. We define comparable operations (or same store operations) as those funeral and cemetery locations that were owned for the entire period beginning January 1, 2004 and ending December 31, 2006. The following tables present operating results for funeral and cemetery locations that were owned by us for all three years. As implied by our definition of comparable operations, these results specifically exclude any impact from the Alderwoods acquisition.

2006	Consolidated	Less: Activity Associated with Acquisition/New Construction	Less: Activity Associated with Dispositions	Comparable
		(Dollars in millions)		
North America				
Funeral revenue	$ 1,149.7	$ 39.5	$ 20.7	$ 1,089.5
Cemetery revenue	591.1	16.3	12.2	562.6
	1,740.8	55.8	32.9	1,652.1
Other foreign				
Funeral revenue	6.5			6.5
Total revenues	$ 1,747.3	$ 55.8	$ 32.9	$ 1,658.6
North America				
Funeral gross profits	$ 236.0	$ 8.1	$ 0.9	$ 227.0
Cemetery gross profits	108.3	2.3	(1.2)	107.2
	344.3	10.4	(0.3)	334.2
Other foreign				
Funeral gross profits	0.4			0.4
Total gross profit	$ 344.7	$ 10.4	$ (0.3)	$ 334.6

Table of Contents

2005	Consolidated	Less: Activity Associated with Dispositions	Comparable
		(Dollars in millions)	
North America			
Funeral revenue	$ 1,143.6	$ 65.8	$ 1,077.8
Cemetery revenue	560.3	30.2	530.1
	1,703.9	96.0	1,607.9
Other foreign			
Funeral revenue	7.1	0.1	7.0
Total revenues	$ 1,711.0	96.1	$ 1,614.9
North America			
Funeral gross profits	$ 214.7	$ 4.9	$ 209.8
Cemetery gross profits	81.9	(2.4)	84.3
	296.6	2.5	294.1
Other foreign			
Funeral gross profits	0.4		0.4
Total gross profit	$ 297.0	$ 2.5	$ 294.5

2004	Consolidated	Less: Activity Associated with Dispositions	Comparable
		(Dollars in millions)	
North America			
Funeral revenue	$ 1,120.1	$ 100.6	$ 1,019.5
Cemetery revenue	570.1	37.3	532.8
	1,690.2	137.9	1,552.3
Other foreign			
Funeral revenue	134.2	127.3	6.9
Cemetery revenue	1.3	1.3	

		135.5		128.6		6.9
Total revenues	$	1,825.7	$	266.5	$	1,559.2
North America						
Funeral gross profits	$	214.7	$	8.7	$	206.0
Cemetery gross profits		102.1		(4.1)		106.2
		316.8		4.6		312.2
Other foreign						
Funeral gross profits		11.5		11.6		(0.1)
Cemetery gross profits		0.1		0.1		
		11.6		11.7		(0.1)
Total gross profit	$	328.4	$	16.3	$	312.1

Table of Contents

The following table provides the data necessary to calculate our comparable average revenue per funeral service in North America for the years ended December 31, 2006, 2005, and 2004. 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. The following data specifically excludes any impact from the Alderwoods acquisition.

	2006	2005	2004
	(Dollars in millions, except average revenue per funeral service)		
Comparable North America funeral revenue	$ 1,089.5	$ 1,077.8	$ 1,019.5
Less: GA revenues	30.7	26.8	26.9
Kenyon revenues	4.6	23.9	3.4
Adjusted Comparable North America funeral revenue	$ 1,054.2	$ 1,027.1	$ 989.2
Comparable North America funeral services performed	220,312	233,880	230,270
Comparable North America average revenue per funeral service	$ 4,785	$ 4,391	$ 4,296

Funeral Results

Consolidated Funeral Revenue

Consolidated revenues from funeral operations were $1,156 million in the year ended December 31, 2006 compared to $1,151 million in the same period of 2005. An increase of $36.5 million, representing the operations of former Alderwoods businesses since the acquisition date, combined with higher average revenue per funeral service and an increase in floral revenues of approximately $10.7 million. These increases were offset by a decline in funeral services performed due to a decrease in funeral properties as a result of our continuing efforts to dispose of non-strategic locations. We also believe the decline reflects a decrease in the number of deaths in the markets we serve. Additionally, Kenyon s revenue declined $19.3 million to $4.6 million, as services related to incidents in Asia, Greece, and U.S. gulf coast in 2005 were not replaced by similar services in 2006.

Consolidated revenues from funeral operations declined by $103.6 million in 2005 compared to 2004 primarily due to the sale of funeral operations in France, which contributed $127.3 million in revenues during 2004. The decrease in revenues related to our former French operations was partially offset by an increase in North America revenues of $23.5 million. This increase was primarily due to an increase in Kenyon s revenues of $20.5 million over the prior year, resulting from disaster management services provided in Asia, Greece, and the U.S. gulf coast in 2005.

Comparable Funeral Revenue

North America comparable funeral revenue increased $11.7 million for the year ended December 31, 2006 compared to the year ended December 31, 2005. However, Kenyon revenue decreased $19.3 million as described above. Excluding the decrease in Kenyon, North America comparable funeral revenue increased $31.0 million, reflecting higher average revenue per funeral service and an increase in floral revenue described above. General agency revenue also increased $3.8 million, or 14.2% in 2006 compared to 2005 as a result of a favorable mix shift in the types of preneed funeral insurance contracts sold. These improvements were partially offset by a decline in volume.

North America comparable funeral revenue in 2005 increased $58.3 million over 2004. Increases in Kenyon revenue as described above contributed $20.5 million of the increase. The remaining increase was primarily a result of an increase in comparable atneed revenue resulting from an increase in funeral volume and a higher average revenue per funeral.

Funeral Services Volume

The overall success of our strategic pricing initiative was partially offset by a 5.8% decrease in comparable funeral volume in 2006 compared to 2005. We believe this decline reflects a decrease in the number of deaths within the markets where we compete, due in part to an unusually warm winter season in the first quarter of 2006. The decline in deaths was particularly pronounced in the first quarter of 2006 in the Northeast United States where we have a high concentration of operations. Also impacting the decline in volume were certain local business decisions to exit unprofitable business relationships and activities. These decisions were made based on our customer segmentation strategy, which focuses on higher market share opportunities with certain customer segments. We will continue to evaluate existing relationships and may ultimately choose to exit other markets as we maintain focus on our strategy. Our cremation rate of 40.9% in 2006 was flat compared to 2005. We have seen the upward trend in our cremation rate flatten despite the continued increase in the markets where we compete, reflecting the impact of our decision to exit unprofitable immediate cremation activities.

Average Revenue Per Funeral

Our recent focus on strategic pricing, beginning in late 2005, has resulted in a 9.0% increase in comparable average revenue per funeral service or $394 per funeral service (7.9% or $340 per service excluding a floral revenue increase) in 2006 over 2005, and an increase of 1.4% in 2005 compared to 2004. 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 service areas where our customers believe we add the most value. This has resulted in a loss in volume from highly discounted, low-service cremation customers. These initiatives, although reducing our funeral services volume, have generated significant improvements in average revenue per funeral service.

Funeral Gross Profit

Consolidated funeral gross profit increased $21.3 million in 2006, primarily due to decreases in costs and $9.9 million contributed from former Alderwoods operations. Significant cost decreases included a $10.7 million decline in salary and fringe expense due to more centralization and standardization in our organization as well as a decrease in selling costs resulting from lower case volume. These gross profit improvements were partially offset by a $4.6 million decline in Kenyon s gross profits, which resulted from fixed costs incurred over a lower revenue base.

Consolidated funeral gross profits decreased $11.1 million in 2005 as compared to 2004 reflecting the disposition of our French operations in March 2004.

Comparable Funeral Gross Profit

Comparable North America funeral gross profit increased $17.2 million or 8.2% in 2006 versus 2005. The comparable funeral gross margin percentage increased to 20.8% in 2006 compared to 19.5% in 2005. The comparable revenue increases described above and continued cost improvements to our infrastructure, including a decrease in salary and fringe expense totaling $5.8 million, were partially offset by the $4.6 million decrease in gross profit from Kenyon s operations.

Our comparable North America funeral gross profit improved $5.2 million (2.5%) in 2005 versus 2004; however, the comparable funeral gross margin percentage decreased to 19.5% compared to 20.1% in 2004. Despite the improved comparable revenues discussed above, margin percentages declined because of increased costs, which included a $4.7 million effect from our change in accounting for deferred selling costs as well as inflationary increases in merchandise costs, increases in group health and pension costs, and increased costs related to our trust reconciliation projects and Sarbanes-Oxley compliance activities.

Cemetery Results

Cemetery Revenue

Consolidated revenues from our cemetery operations increased $30.8 million in 2006 compared to 2005, reflecting higher atneed revenues and increased delivery of preneed merchandise combined with a $14.4 million increase from operations acquired from Alderwoods. Also contributing to the increase was the receipt and recognition of $7.9 million in endowment care income in 2006.

Consolidated cemetery revenues decreased $11.0 million in 2005 versus 2004 due to a $9.8 million decline in North America operations. Approximately $11.3 million of the decrease was due to a decrease in the number of SCI s North American properties as a result of our continued effort to dispose of non-strategic locations.

Comparable Cemetery Revenue

North America comparable cemetery revenue increased $32.5 million or 6.1% in 2006 compared to 2005. The increase primarily resulted from a $10 million increase in cemetery atneed revenues as well as an increase in trust fund income, partially offset by lower interest income on preneed receivables.

North America comparable cemetery revenue decreased $2.7 million or .5% in 2005 compared to 2004. This decrease primarily resulted from declines associated with constructed cemetery property and interest on trade receivables. Decreases in interest on trade receivables resulted from an increase in the number of contracts that were not financed, increased down payments, and shorter financing terms.

Cemetery Gross Profits

Consolidated cemetery gross profit increased $26.4 million or 3.7% in 2006 compared to 2005. Cemetery gross margin percentages increased from 14.6% in 2005 to 18.3% in 2006, reflecting $1.7 million from operations acquired from Alderwoods, the endowment care income received and recognized in 2006 related to the resolution of a dispute over the funds, and an increase in other trust fund income.

Consolidated cemetery gross profits decreased $20.2 million in 2005 as compared to 2004. These declines were due to the decrease in revenue discussed above, coupled with a $9.5 million negative impact from our change in accounting related to deferred selling costs.

Comparable Cemetery Gross Profit

North America comparable cemetery gross profits increased $22.9 million in 2006 compared to 2005. The comparable cemetery percentage increased to 19.1% in 2006 from 15.9% in 2005. These improvements were a result of the increases in atneed cemetery revenues and in endowment care trust fund income discussed above and cost improvements. Selling and salary expenses decreased in 2006 due to increased centralization within our organization. The decrease in these expenses was partially offset by higher maintenance and utilities costs primarily resulting from increased fuel costs.

North America comparable cemetery gross profits decreased $21.9 million in 2005 compared to 2004 due to the decrease in revenue and the change in accounting for deferred selling costs described above. The comparable cemetery gross margin percentage decreased to 15.9% in 2005 from 19.9% in 2004.

Other Financial Statement Items

General and Administrative Expenses

General and administrative expenses were $94.9 million in 2006 compared to $84.8 million in 2005 and $130.9 million in 2004. For 2006 compared to 2005, general and administrative costs increased $10.1 million primarily due to $7.0 million in expenses related to our acquisition of Alderwoods and $3.9 million of share-based compensation costs related to stock options expensed under FAS 123(R). These costs were partially offset by a decrease in salary expense. Included in 2004 expenses were non-recurring litigation expenses (net of insurance recoveries of $1.6 million) of $61.1 million.

Gains (Losses) on Dispositions and Impairment Charges, Net

In 2006, we recognized a $58.7 million net pretax impairment loss. This loss was primarily associated with the disposition of underperforming funeral and cemetery businesses in North America, including a $16.6 million impairment of assets sold to StoneMor Partners LP and a $26.4 million impairment of certain assets in Michigan for

Table of Contents

which we have commenced a plan to sell and which are classified as assets held for sale at December 31, 2006. Additionally, in connection with the Alderwoods acquisition, we have entered into a consent agreement with the Federal Trade Commission to divest certain of our non-Alderwoods properties, and we have recorded an impairment charge of $12.9 million for these properties which were owned by us and are classified as assets held for sale at December 31, 2006.

In 2005, we recognized a $26.1 million net pretax loss from impairments. This loss was primarily associated with the disposition of underperforming funeral and cemetery businesses in North America (including a $30.0 million impairment of assets sold to StoneMor Partners LP). The net loss was partially offset by the release of approximately $15.6 million in indemnification liabilities previously recorded in connection with the 2004 sales of our United Kingdom and French operations.

In 2004, we recognized a $25.8 million net pretax gain from our disposition activities, including a $41.2 million gain from the sale of our equity and debt holdings in our former United Kingdom operations and a $6.4 million gain from the disposition of our French funeral operations. These gains were partially offset by net losses associated with various dispositions in North America. For further information regarding gains (losses) on dispositions and impairment charges, net see Note 21 to the consolidated financial statements in Item 8 of this Form 10-K.

Interest Expense

Interest expense increased to $123.4 million in 2006, compared to $103.7 million in 2005 and $119.3 million in 2004. The increase of $19.7 million in interest expense between 2006 and 2005 resulted primarily from $6.4 million in bridge financing costs related to the Alderwoods acquisition and an incremental $10.5 million of interest costs related to our increased borrowings to finance the Alderwoods acquisition in the fourth quarter of 2006.

Interest expense in 2005 was $36.3 million less than 2004 as a result of less outstanding debt in 2005.

Interest Income

Interest income of $31.2 million in 2006, a $14.5 million increase over 2005, reflects the increase in our cash balance for most of 2006 coupled with an increase in interest rates.

Interest income of $16.7 million in 2005, compared to $13.5 million in 2004, reflects the increase in our cash balance invested in commercial paper, which contributed $7.2 million. This increase was partially offset by $4.5 million of reduced interest income related to a note receivable from our former investment in a United Kingdom company, which was collected in full in 2004.

Loss on Early Extinguishment of Debt

During 2006, we repurchased $139.0 million aggregate principal amount of our 7.7% notes due 2009 in a tender offer in the fourth quarter and prepaid $50.0 million of our term loan in December 2006. As a result of these transactions, we recognized a loss of $17.5 million, which is composed of the redemption premiums paid of $8.2 million and the write-off of unamortized deferred loan costs of $9.3 million.

During 2005, we repurchased $16.6 million aggregate principal amount of our 7.70% notes due 2009 in the open market, and $0.3 million aggregate principal amount of our 6.00% notes due 2005 in the open market. Also during 2005, we redeemed $130.0 million aggregate principal amount of our 6.875% notes due 2007 and $139.3 million aggregate principal amount of our 7.20% notes due 2006, pursuant to a tender offer for such notes. As a result of these transactions, we recognized a loss of $14.3 million, which is comprised of the redemption premiums paid of

$12.2 million and the write-off of unamortized debt issuance costs of $2.1 million.

In 2004, we extinguished $200.0 million aggregate principal amount of our 6.00% notes due 2005, pursuant to the Offer to Purchase dated March 24, 2004. We also purchased $8.7 million aggregate principal amount of our 6.00% notes due 2005 in the open market. The holders of $221.6 million of our 6.75% convertible subordinated notes due 2008 converted their holdings to equity in June 2004, pursuant to the terms of the notes. Simultaneously, we exercised our option by redeeming the remaining outstanding $91.1 million of the notes. As a result of these transactions, we recognized a loss on the early extinguishment of debt of $16.8 million.

Other Income, Net

Other income, net was $16.1 million in 2006, compared to $2.3 million in 2005 and $8.7 million in 2004. Key components of other income for the years presented are as follows:

Investment income of $10.9 million was received and recognized in 2006 from the redemption of a portion of our ownership interest in our operations in France.

Equity income of $1.1 million was recognized in 2006 from our French equity investment.

Cash overrides received from a third party insurance provider related to the sale of insurance-funded preneed funeral contracts were $5.6 million in 2006, compared to $6.0 million in 2005 and $6.3 million in 2004.

Surety bond premium costs were $4.0 million in 2006, compared to $3.6 million in 2005 and $4.0 million in 2004.

(Provision) Benefit for Income Taxes

The consolidated effective tax rate in 2006 resulted in a provision of 46.0%, compared to a provision of 36.8% in 2005 and a benefit of 6.8% in 2004. The 2006 and 2005 tax rates were negatively impacted by permanent differences between the book and tax bases of North American asset dispositions and the 2005 tax rate was partially offset by state net operating loss benefits. The 2004 tax rate was favorably impacted by tax benefits resulting from the disposition of our operations in France and the United Kingdom and from state net operating losses realized in 2004. The tax benefits from dispositions result from differences between book and tax bases and from the reversal of tax liabilities that were then recorded as warranty indemnification liabilities.

Weighted Average Shares

The weighted average number of shares outstanding was 297.4 million in 2006, compared to 306.7 million in 2005 and 344.7 million in 2004. The decrease in all years was mainly due to our share repurchase program, which began in the third quarter of 2004. Additionally, the decrease from 2004 to 2005 was related to the contribution of cash to our 401(k) retirement plan. Effective January 1, 2005, we began contributing cash to fund the Company s matching contribution to our 401(k) retirement plan and discontinued funding through the use of common stock.

Critical Accounting Policies, Recent Accounting Pronouncements and Accounting Changes

Our consolidated financial statements are impacted by the accounting policies used and the estimates and assumptions made by management during their preparation. See Note 2 to the consolidated financial statements in Item 8 of this Form 10-K. Estimates and assumptions affect the carrying values of assets and liabilities and disclosures of contingent assets and liabilities at the balance sheet date. Actual results could differ from such estimates due to uncertainties associated with the methods and assumptions underlying our critical accounting measurements. The following is a discussion of our critical accounting policies pertaining to revenue recognition, business combinations, the impairment or disposal of long-lived assets, and the use of estimates.

Revenue Recognition

Funeral revenue is recognized when funeral services are performed. Our trade receivables primarily consist of amounts due for funeral services already performed. Revenue associated with cemetery merchandise and services is recognized when the service is performed or merchandise is delivered. Revenue associated with cemetery property interment rights is recognized in accordance with the retail land sales provision of SFAS No. 66, *Accounting for the Sales of Real Estate* (SFAS 66). Under SFAS 66, revenue from constructed cemetery property is not recognized until a minimum percentage (10%) of the sales price has been collected. Revenue related to the preneed sale of unconstructed cemetery property is deferred until it is constructed and 10% of the sales price is collected.

37

When a customer enters into a preneed funeral trust contract, the entire purchase price is deferred and the revenue is recognized at the time of maturity. The revenues associated with a preneed cemetery contract, however, may be recognized as different contract events occur. Preneed sales of cemetery interment rights (cemetery burial property) are recognized when a minimum of 10% of the sales price has been collected and the property has been constructed or is available for interment. For personalized marker merchandise, with the customer s direction generally obtained at the time of sale, we can choose to order, store, and transfer title to the customer. Upon the earlier of vendor storage of these items or delivery in our cemetery, we recognize the associated revenues and record the cost of sale. For services and non-personalized merchandise (such as vaults), we defer the revenues until the services are performed and the merchandise is delivered.

Business Combinations

We apply the principles provided in SFAS 141 when we acquire businesses. Tangible and intangible assets and liabilities assumed are recorded at their fair value and goodwill recognized for any difference between the price of the acquisition and our fair value determination. We customarily estimate our purchase costs and other related transactions known to us at closing of the acquisition. To the extent that information not available to us at the closing date subsequently becomes available during the allocation period, as defined in SFAS 141, we may adjust our goodwill, assets, or liabilities associated with the acquisition. These changes are disclosed in future reports as they occur.

On November 28, 2006, we completed the acquisition of Alderwoods for $20.00 per share in cash, resulting in a purchase price of $1.2 billion, which includes the refinancing of $357.7 million and the assumption of $2.2 million of Alderwoods debt resulting in goodwill of $183.0 million. Alderwoods properties have been substantially integrated into our operations at December 31, 2006. These properties are operated in the same manner as our incumbent properties, under our leadership, and are reported in the appropriate reporting unit (segment) whether funeral or cemetery in our consolidated financial statements. See Part II, Item 8. Financial Statements and Supplementary Data, Note 5 for details related to this acquisition.

Impairment or Disposal of Long-Lived Assets

We test for impairment of goodwill using a two-step approach as prescribed in SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The first step of our goodwill impairment test compares the fair value of a reporting unit with its carrying amount including goodwill. Reporting units for SCI are the funeral and cemetery segments. We do not record an impairment of goodwill in instances where the fair value of a reporting unit exceeds its carrying amount. If fair value is less than the carrying amount for a reporting unit, we would perform the second step which is to compare the implied fair value of goodwill (as defined in SFAS 142) to the carrying amount of goodwill. If the carrying amount of a reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Fair market value of a reporting unit is determined using a calculation based on multiples of revenue and multiples of EBITDA, or earnings before interest, taxes, depreciation, and amortization, of both SCI and its competitors. Based on our impairment tests performed during the fourth quarter using September 30th information, there was no impairment of goodwill at December 31, 2006 or 2005.

We review our other non-goodwill long-lived assets for impairment when changes in circumstances indicate that the carrying amount of the asset may not be recoverable, in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). SFAS 144 requires that long-lived assets to be held and used are reported at the lower of their carrying amount or fair value. Assets to be disposed of and assets not expected to provide any future service potential are recorded at the lower of their carrying amount or fair value less estimated cost to sell.

In October 2006, we sold our remaining funeral businesses in Singapore for proceeds of approximately $11.6 million of which $1.0 million is due in the second quarter of 2007. Other divestitures in 2006 and assets held for sale at December 31, 2006 resulted in $58.7 million in net losses on dispositions and impairment charges.

In November 2005, we sold 21 cemeteries and six funeral homes to StoneMor Partners LP. In the third quarter of 2005, we committed to a plan to sell these locations and classified these properties as held for sale. Pursuant to our impairment policy under SFAS 144, we recorded an impairment charge of $25.3 million in our cemetery segment and $4.7 million in our funeral segment.

During the second quarter of 2004, we committed to a plan to divest our funeral and cemetery operations in Argentina and Uruguay. Upon this triggering event, we tested these operations for impairment. As a result of this impairment test, we recorded an impairment charge of $15.2 million in our 2004 consolidated financial statements.

Use of Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles in the United States (GAAP) requires management to make certain estimates and assumptions. These estimates and assumptions affect the carrying values of assets and liabilities and disclosures of contingent assets and liabilities at the balance sheet date. Actual results could differ from such estimates due to uncertainties associated with the methods and assumptions underlying our critical accounting measurements. Key estimates used by management, among others, include:

Allowances We provide various allowances and/or cancellation reserves for our funeral and cemetery preneed and at need receivables, as well as for our preneed funeral and preneed cemetery deferred revenues. These allowances are based on an analysis of historical trends and include, where applicable, collection and cancellation activity. We also record an estimate of general agency revenues that may be cancelled in their first year, where the revenue would be charged back by the insurance company. These estimates are impacted by a number of factors, including changes in economy, relocation, and demographic or competitive changes in our areas of operation.

Valuation of trust investments With the implementation of revised FASB Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* (FIN 46R), as of March 31, 2004, we removed the receivables due from trust assets recorded at cost from our balance sheet and added the actual trust investments recorded at market value. The trust investments include marketable securities that are classified as available-for-sale in accordance with Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities.* Where quoted market prices are not available, we obtain estimates of fair value from the managers of the private equity funds, which are based on the market value of the underlying real estate and private equity investments. These market values are based on contract offers for the real estate or the managers appraisals of the venture capital funds.

Legal liability reserves Contingent liabilities, principally for legal liability matters, are recorded when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated in accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies.* Liabilities accrued for legal matters require judgments regarding projected outcomes and range of loss based on historical experience and recommendations of legal counsel. However, litigation is inherently unpredictable, and excessive verdicts do occur. As disclosed in Note 15 of the consolidated financial statements, our legal exposures and the ultimate outcome of these legal proceedings could be material to operating results or cash flows in any given quarter or year.

Depreciation of long-lived assets We depreciate our long-lived assets ratably over their estimated useful lives. These estimates of useful lives may be affected by such factors as changing market conditions or changes in regulatory requirements.

Valuation of assets acquired and liabilities assumed We apply the principles of SFAS 141 when we acquire businesses. Tangible and intangible assets and liabilities assumed are recorded at their fair value and goodwill recognized for any difference between the price of acquisition and our fair value determination. We customarily estimate our purchase costs and other related transactions known to us at closing of the acquisition. To the extent that information not available to us at the closing date subsequently becomes available during the allocation period, as defined in SFAS 141, we may adjust our goodwill, assets, or liabilities associated with the acquisition.

Income taxes Our ability to realize the benefit of certain of our federal and state deferred tax assets requires us to achieve certain future earnings levels. We have established a valuation allowance against a portion of our deferred tax assets and could be required to further adjust that valuation allowance if market conditions change materially and future earnings are, or are projected to be, significantly different from our current estimates. We intend to permanently reinvest the unremitted earnings of certain of our foreign subsidiaries in those businesses outside the United States and, therefore, have not provided for deferred federal income taxes on such unremitted foreign earnings.

A number of years may elapse before particular tax matters, for which we have established accruals, are audited and finally resolved. The number of tax years with open tax audits varies depending on the tax jurisdiction. In the United States, the Internal Revenue Service is currently examining our tax returns for 1999 through 2004 and various state jurisdictions are auditing years through 2005. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, we believe that our accruals reflect the probable outcome of known tax contingencies. Unfavorable settlement of any particular issue would reduce a deferred tax asset or require the use of cash. Favorable resolution could result in reduced income tax expense reported in the financial statements in the future. Our tax accruals are presented in the balance sheet within *Deferred income taxes* and *Other liabilities.*

Pension cost Our pension plans are frozen with no benefits accruing to participants except interest. Pension costs and liabilities are actuarially determined based on certain assumptions, including the discount rate used to compute future benefit obligations. On January 1, 2004, we changed our method of accounting for gains and losses on pension assets and obligations to recognize such gains and losses in our consolidated statement of operations during the year in which they occur. Therefore, the concept of an expected rate of return on plan assets is not applicable.

Discount rates used to determine pension obligations for our pension plans in 2006 were 5.75% for the SCI SERP, Senior SERP and Directors Plans and 5.5% for all other plans. Discount rates for all plans were 5.75% and 6.00% for the years ended 2005, and 2004, respectively. We determine the discount rate used to compute future benefit obligations using an analysis of expected future benefit payments. We verify the reasonableness of the discount rate by comparing our rate to the rate earned on high-quality fixed income investments, such as the Moody s Aa index. At December 31, 2006, 63% of our plan assets were held as cash and cash equivalents and the remaining 37% of plan assets were invested in equity securities. As of December 31, 2006, the equity securities were invested approximately 56% in U.S. Large Cap investments, 22% in international equities and 22% in U.S. Small Cap investments. Our current investment objective is to liquidate our plan assets as we have begun the process to terminate these Plans and expect to complete this termination by mid-2007.

A sensitivity analysis of the net periodic benefit cost was modeled to assess the impact that changing discount rates could have on pre-tax earnings. The sensitivity analysis assumes a 0.25% adverse change to the discount rate with all other variables held constant. Using this model, our pre-tax earnings would have decreased by less than $2.0 million, or less than $.01 per diluted share, for the year ended December 31, 2006. See Note 17 to the consolidated financial statements in Item 8 of this Form 10-K for more information related to our pension plans.

Insurance loss reserves We purchase comprehensive general liability, morticians and cemetery professional liability, automobile liability, and workers compensation insurance coverages structured with high deductibles. This high deductible insurance program means we are primarily self-insured for claims and associated costs and losses covered by these policies. Historical insurance industry experience indicates a high degree of inherent variability in assessing the ultimate amount of losses associated with casualty insurance claims. This is especially true with respect to liability and workers compensation exposures due to the extended period of time that transpires between when the claim might occur and the full settlement of such claim, often many years. We continually evaluate loss estimates associated with claims and losses related to these insurance coverages and falling within the deductible of each coverage through the use of qualified and independent actuaries. Assumptions based on factors such as claim settlement patterns, claim development trends, claim frequency and severity patterns, inflationary trends and data reasonableness will generally effect

Table of Contents

the analysis and determination of the best estimate of the projected ultimate claim losses. The results of these actuarial evaluations are used to both analyze and adjust our insurance loss reserves.

As of December 31, 2006, reported losses within our retention for workers compensation, general liability and auto liability incurred during the period May 1, 1987 through December 31, 2006 were approximately $254.1 million over the 19.5 years. The selected fully developed ultimate settlement value estimated by our independent actuary was $304.1 million for the same period. Paid losses were $236.4 million indicating a reserve requirement of $67.7 million. After considering matters discussed with our independent actuary related to this calculation, we estimated the reserve to be $67.7 million as of December 31, 2006.

At December 31, 2006 and 2005, the balances in the reserve for workers compensation, general, and auto liability and the related activity were as follows:

	(Dollars in millions)	
Balance at December 31, 2004	$	47.3
Additions		20.1
Payments		(18.4)
Balance at December 31, 2005	$	49.0
Additions		29.2
Acquisition		21.0
Payments		(31.5)
Balance at December 31, 2006	$	67.7

Recent Accounting Pronouncements and Accounting Changes

For discussion of recent accounting pronouncements and accounting changes, see Part II, Item 8. Financial Statements and Supplementary Data, Note 3.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk.***

The information presented below should be read in conjunction with Notes 13 and 14 to the consolidated financial statements in Item 8 of this Form 10-K.

We have historically used derivatives primarily in the form of interest rate swaps, cross-currency interest rate swaps, and forward exchange contracts in combination with local currency borrowings in order to manage our mix of fixed and floating rate debt and to hedge our net investment in foreign assets. We do not participate in derivative transactions that are leveraged or considered speculative in nature. None of our market risk sensitive instruments are entered into for trading purposes. All of the instruments described below were entered into for other than trading purposes.

We did not enter into any derivatives during 2006 and do not have any derivatives outstanding at December 31, 2006.

At December 31, 2006 and 2005, 82% and 99%, respectively, of our total debt consisted of fixed rate debt at a weighted average rate of 7.30% and 7.11%, respectively.

At December 31, 2006, approximately 11% of our stockholders equity and 7% of our operating income were denominated in foreign currencies, primarily the Canadian dollar. Approximately 4% of our stockholders equity and 8% of our operating income were denominated in foreign currencies, primarily the Canadian dollar, at December 31, 2005. We do not have a significant investment in foreign operations that are in highly inflationary economies.

Marketable Equity and Debt Securities Price Risk

In connection with our preneed funeral operations and preneed cemetery merchandise and service sales, the related funeral and cemetery trust funds own investments in equity and debt securities and mutual funds, which are

Table of Contents

sensitive to current market prices. Cost and market values as of December 31, 2006 are presented in Notes 6, 7, and 8 to the consolidated financial statements in Item 8 of this Form 10-K.

Market-Rate Sensitive Instruments Interest Rate and Currency Risk

We perform a sensitivity analysis to assess the impact of interest rate and exchange rate risks on earnings. This analysis determines the effect of a hypothetical 10% adverse change in market rates. In actuality, market rate volatility is dependent on many factors that are impossible to forecast. Therefore, the adverse changes described below could differ substantially from the hypothetical 10% change.

We are currently not subject to significant interest rate risk on our outstanding debt as 82% of such debt has fixed rate interest terms. The fair market value of our debt was approximately $43.8 million more than its carrying value at December 31, 2006. A fifty basis point increase in our floating rate risk would increase interest expense by $2 million.

A similar model was used to assess the impact of changes in exchange rates for foreign currencies on the Company s consolidated statement of operations. At December 31, 2006 and 2005, our foreign currency exposure was primarily associated with the Canadian dollar, the Chilean pesos and the euro. A 10% adverse change in the strength of the U.S. dollar relative to the foreign currency instruments would have negatively affected our income from our continuing operations on an annual basis, by less than $0.7 million for the year ended December 31, 2006 and less than $0.5 million for the year ended December 31, 2005.

Item 8. ***Financial Statements and Supplementary Data.***

INDEX TO FINANCIAL STATEMENTS AND RELATED SCHEDULE

All other schedules have been omitted because the required information is not applicable or is not present in amounts sufficient to require submission or because the information required is included in the consolidated financial statements or the related notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of
Service Corporation International:

We have completed integrated audits of Service Corporation International s consolidated financial statements and of its internal control over financial reporting as of December 31, 2006, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the accompanying index present fairly in all material respects, the financial position of Service Corporation International and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 4 to the consolidated financial statements, the Company changed its method of accounting for share-based compensation effective January 1, 2006. As discussed in Note 3 to the consolidated financial statements, the Company changed its method of accounting for deferred selling costs related to preneed funeral and cemetery contracts effective January 1, 2005, and its method of accounting for variable interest entities effective March 31, 2004.

Internal control over financial reporting

Also, in our opinion, management s assessment, included in Management s Report on Internal Control over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the COSO. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management s Report on Internal Control Over Financial Reporting appearing under Item 9A, management has excluded Alderwoods Group, Inc. (Alderwoods) from its assessment of internal control over financial reporting as of December 31, 2006 because it was acquired by the Company in a purchase business combination during the fourth quarter of 2006. We have also excluded Alderwoods from our audit of internal control over financial reporting. The total assets and total revenues of Alderwoods represent approximately 13% and 3%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2006.

PricewaterhouseCoopers LLP
Houston, Texas
February 28, 2007

Table of Contents

SERVICE CORPORATION INTERNATIONAL

CONSOLIDATED STATEMENT OF OPERATIONS

	Years Ended December 31,		
	2006	2005	2004
	(In thousands, except per share amounts)		
Revenues	$ 1,747,295	$ 1,710,977	$ 1,825,743
Costs and expenses	(1,402,627)	(1,413,965)	(1,497,396)
Gross profits	344,668	297,012	328,347
General and administrative expenses	(94,900)	(84,834)	(130,884)
Gains (losses) on dispositions and impairment charges, net	(58,683)	(26,093)	25,797
Operating income	191,085	186,085	223,260
Interest expense	(123,399)	(103,733)	(119,293)
Interest income	31,171	16,706	13,453
Loss on early extinguishment of debt	(17,532)	(14,258)	(16,770)
Other income, net	16,124	2,327	8,668
Income from continuing operations before income taxes and cumulative effect of accounting changes	97,449	87,127	109,318
(Provision) benefit for income taxes	(44,845)	(32,036)	8,103
Income from continuing operations before cumulative effect of accounting changes	52,604	55,091	117,421
Income from discontinued operations (net of income tax benefit (provision) of $2,548, $(5,961) and $48,722, respectively)	3,907	4,506	43,833
Cumulative effect of accounting changes (net of income tax benefit of $117,428 and $22,907, respectively)		(187,538)	(50,593)
Net income (loss)	$ 56,511	$ (127,941)	$ 110,661
Basic earnings (loss) per share:			
Income from continuing operations before cumulative effect of accounting changes	$ .18	$ .18	$ .37
Income from discontinued operations, net of tax	.01	.02	.14
Cumulative effect of accounting changes, net of tax		(.62)	(.16)
Net income (loss)	$ .19	$ (.42)	$ .35
Basic weighted average number of shares	292,859	302,213	318,737
Diluted earnings (loss) per share:			
Income from continuing operations before cumulative effect of accounting changes	$ .18	$ .18	$ .36

Income from discontinued operations, net of tax		.01		.01		.13
Cumulative effect of accounting changes, net of tax				(.61)		(.15)
Net income (loss)	$	.19	$	(.42)	$	.34
Diluted weighted average number of shares		297,371		306,745		344,675
Dividends declared per share	$	.105	$	.10	$	

(See notes to consolidated financial statements)

Table of Contents

SERVICE CORPORATION INTERNATIONAL

CONSOLIDATED BALANCE SHEET

	December 31, 2006	December 31, 2005
	(In thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 39,880	$ 446,782
Receivables, net	107,194	97,747
Inventories	39,535	31,254
Current assets of discontinued operations	2,236	
Current assets held for sale	6,330	
Other	43,162	37,527
Total current assets	238,337	613,310
Preneed funeral receivables and trust investments	1,516,676	1,226,192
Preneed cemetery receivables and trust investments	1,522,584	1,288,515
Cemetery property, at cost	1,495,248	1,392,727
Property and equipment, at cost, net	1,641,353	950,174
Non-current assets of discontinued operations	371,132	
Non-current assets held for sale	349,311	
Goodwill	1,264,272	1,123,888
Deferred charges and other assets	436,545	249,581
Cemetery perpetual care trust investments	893,931	700,382
	$ 9,729,389	$ 7,544,769
LIABILITIES & STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 341,173	$ 231,693
Current maturities of long-term debt	46,176	20,716
Current liabilities of discontinued operations	2,351	
Current liabilities held for sale	419	
Income taxes	17,828	20,359
Total current liabilities	407,947	272,768
Long-term debt	1,912,696	1,186,485
Deferred preneed funeral revenues	537,792	535,384
Deferred preneed cemetery revenues	754,193	792,485
Deferred income taxes	177,341	138,677
Non-current liabilities of discontinued operations	311,498	

Non-current liabilities held for sale	239,800	
Other liabilities	357,418	326,985
Non-controlling interest in funeral and cemetery trusts	2,548,743	2,015,811
Non-controlling interest in perpetual care trusts	887,186	694,619
Commitments and contingencies (Note 15)		
Stockholders equity:		
Common stock, $1 per share par value, 500,000,000 shares authorized, 293,222,114 and 294,808,872 issued and outstanding (net of 10,000 and 48,962,063 treasury shares at par, respectively)	293,222	294,809
Capital in excess of par value	2,135,649	2,182,745
Unearned compensation		(3,593)