

SERVICE CORPORATION INTERNATIONAL

Form 10-Q/A

August 14, 2006

Table of Contents

**FORM 10-Q/A
(Amendment No. 1)
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549**

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

For the quarterly period ended September 30, 2005

or

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

For the transition period from _____ to _____

Commission file number 1-6402-1

SERVICE CORPORATION INTERNATIONAL
(Exact name of registrant as specified in charter)

Texas

(State or other jurisdiction of
incorporation or organization)

74-1488375

(I. R. S. employer identification
number)

1929 Allen Parkway, Houston, Texas

(Address of principal executive offices)

77019

(Zip code)

713-522-5141

(Registrant's telephone number, including area code)

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 and (2) has been subject to the filing requirements for the past 90 days.

YES

NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in the Securities Exchange Act of 1934 Rule 12b-2).

YES

NO

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

YES

NO

The number of shares outstanding of the registrant's common stock as of November 4, 2005 was 296,561,925 (net of treasury shares).

Table of Contents

Explanatory Note:

The Company is amending its Form 10-Q for the quarterly period ended September 30, 2005 to restate its condensed consolidated financial statements as of September 30, 2005 and December 31, 2004 and for the three and nine month periods ended September 30, 2005 and 2004. Included in this amended Form 10-Q are certain adjustments to correct errors related to (1) the miscalculation of the Company's actuarially determined pension benefit obligation, (2) the accounting for certain leases related to funeral home properties which were previously accounted for as operating leases but should have been accounted for as capital leases, and (3) other adjustments identified in a subsequent period but deemed to be not material, either individually or in the aggregate and corrected in that subsequent period. All applicable amounts relating to this restatement have been reflected in the condensed consolidated financial statements and disclosed in the notes to the condensed consolidated financial statements in this amended Form 10-Q. For a discussion of the individual restatement adjustments, see Item 1. Financial Statements note two. Restatement of Financial Statements. Additionally, see Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

SERVICE CORPORATION INTERNATIONAL

INDEX

	Page
<u>Part I. Financial Information</u>	3
<u>Item 1. Financial Statements</u>	3
<u>Unaudited Condensed Consolidated Statement of Operations Three and Nine Months Ended September 30, 2005 and 2004 (Restated)</u>	3
<u>Unaudited Condensed Consolidated Balance Sheet September 30, 2005 and December 31, 2004 (Restated)</u>	4
<u>Unaudited Condensed Consolidated Statement of Cash Flows Nine Months Ended September 30, 2005 and 2004 (Restated)</u>	5
<u>Unaudited Condensed Consolidated Statement of Stockholders Equity Nine Months Ended September 30, 2005 (Restated)</u>	6
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
<u>Introduction</u>	30
<u>Our Competitive Strengths</u>	30
<u>Business Challenges</u>	31
<u>Where We are Today</u>	32
<u>The Path to Growth</u>	33
<u>Critical Accounting Policies and Accounting Changes</u>	34
<u>Results of Operations Three Months Ended September 30, 2005 and 2004</u>	38
<u>Comparable Results of Operations Three Months Ended September 30, 2005 and 2004</u>	40
<u>Results of Operations Nine Months Ended September 30, 2005 and 2004</u>	42
<u>Comparable Results of Operations Nine Months Ended September 30, 2005 and 2004</u>	45
<u>Financial Condition, Liquidity and Capital Resources</u>	47
<u>Preneed Funeral and Cemetery Activities</u>	50
<u>Cautionary Statement on Forward-Looking Statements</u>	58
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	58
<u>Item 4. Controls and Procedures</u>	59
<u>Part II. Other Information</u>	64
<u>Item 1. Legal Proceedings</u>	64
<u>Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities</u>	64
<u>Item 6. Exhibits</u>	65
<u>Signature</u>	66
<u>Ratio of earnings to fixed charges</u>	
<u>Consent of Independent Registered Public Accounting Firm</u>	
<u>Certification of Principal Executive Officer of Section 302</u>	
<u>Certification of Principal Financial Officer of Section 302</u>	
<u>Certification of Periodic Financial Reports as PEO of Section 906</u>	
<u>Certification of Periodic Financial Reports as PFO of Section 906</u>	

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

SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

(In thousands, except per share amounts)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2005	2004	2005	2004
	(Restated)	(Restated)	(Restated)	(Restated)
	note 2	note 2	note 2	note 2
Revenues	\$ 406,369	\$ 397,186	\$ 1,285,653	\$ 1,404,597
Costs and expenses	(347,526)	(328,519)	(1,055,966)	(1,149,170)
Gross profit	58,843	68,667	229,687	255,427
General and administrative expenses	(19,744)	(25,295)	(61,936)	(100,338)
Gains and impairment (losses) on dispositions, net	(27,446)	(3,281)	(28,659)	33,021
Operating income	11,653	40,091	139,092	188,110
Interest expense	(26,170)	(26,955)	(77,399)	(92,147)
Loss on early extinguishment of debt			(14,258)	(16,770)
Other income, net	4,443	4,255	11,756	13,265
	(21,727)	(22,700)	(79,901)	(95,652)
(Loss) income from continuing operations before income taxes and cumulative effects of accounting changes	(10,074)	17,391	59,191	92,458
(Benefit) provision for income taxes	(885)	4,526	26,188	(6,830)
(Loss) income from continuing operations before cumulative effects of accounting changes	(9,189)	12,865	33,003	99,288
(Loss) income from discontinued operations (net of income tax provision (benefit) of \$2,606, \$623, \$4,587 and \$(47,502), respectively)	(463)	850	3,825	34,971
Cumulative effects of accounting changes (net of income tax benefit of \$117,428 and \$22,907, respectively)			(187,538)	(50,593)
Net (loss) income	\$ (9,652)	\$ 13,715	\$ (150,710)	\$ 83,666
Basic (loss) earnings per share:				

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q/A

(Loss) income from continuing operations before cumulative effects of accounting changes	\$	(.03)	\$	.04	\$	.11	\$	.32
Income from discontinued operations, net of tax						.01		.11
Cumulative effects of accounting changes, net of tax						(.62)		(.16)
Net (loss) income	\$	(.03)	\$	.04	\$	(.50)	\$	.27
Diluted (loss) earnings per share:								
(Loss) income from continuing operations before cumulative effects of accounting changes	\$	(.03)	\$	.04	\$	.11	\$	.30
Income from discontinued operations, net of tax						.01		.10
Cumulative effects of accounting changes, net of tax						(.61)		(.14)
Net (loss) income	\$	(.03)	\$	.04	\$	(.49)	\$	.26
Basic weighted average number of shares		297,421		336,590		304,366		315,656
Diluted weighted average number of shares		297,421		340,215		308,807		348,894
Dividends declared per share	\$	.025			\$	.075		

(See notes to unaudited condensed consolidated financial statements)

Table of Contents

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

	September 30, 2005 (Unaudited) (Restated) note 2	December 31, 2004 (Restated) note 2
Assets		
Current assets:		
Cash and cash equivalents	\$ 492,059	\$ 287,785
Receivables, net	82,306	102,622
Inventories	66,158	81,526
Current assets held for sale	12,959	
Current assets of discontinued operations		11,085
Other	55,069	53,820
Total current assets	708,551	536,838
Preneed funeral receivables and trust investments	1,238,123	1,267,784
Preneed cemetery receivables and trust investments	1,295,352	1,399,778
Cemetery property, at cost	1,376,817	1,509,599
Property and equipment, at cost, net	955,078	978,861
Non-current assets held for sale	49,774	
Non-current assets of discontinued operations		4,367
Deferred charges and other assets	259,375	631,839
Goodwill	1,140,509	1,169,040
Cemetery perpetual care trust investments	701,382	729,048
	\$ 7,724,961	\$ 8,227,154
Liabilities & Stockholders Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 233,634	\$ 221,235
Current maturities of long-term debt	91,379	78,164
Current liabilities of discontinued operations		7,111
Income taxes	690	7,850
Total current liabilities	325,703	314,360
Long-term debt	1,195,535	1,200,353
Deferred preneed funeral revenues	558,381	540,794
Deferred preneed cemetery revenues	789,143	803,144
Deferred income taxes	172,601	274,463
Non-current liabilities held for sale	49,985	
Non-current liabilities of discontinued operations		58,225

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q/A

Other liabilities	385,866	437,298
Non-controlling interest in funeral and cemetery trusts	1,973,091	2,050,658
Commitments and contingencies (note 9)		
Non-controlling interest in perpetual care trusts	680,088	704,912
Stockholders' equity:		
Common stock, \$1 per share par value, 500,000,000 shares authorized, 298,148,297 and 323,225,352, issued and outstanding (net of 44,917,591 and 18,502,478 treasury shares, at par)	298,148	323,225
Capital in excess of par value	2,216,952	2,395,057
Unearned compensation	(4,153)	(2,022)
Accumulated deficit	(985,674)	(834,964)
Accumulated other comprehensive income (loss)	69,295	(38,349)
Total stockholders' equity	1,594,568	1,842,947
	\$ 7,724,961	\$ 8,227,154

(See notes to unaudited condensed consolidated financial statements)

Table of Contents

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

	Nine months ended	
	September 30,	
	2005	2004
	(Restated)	(Restated)
	note 2	note 2
Cash flows from operating activities:		
Net (loss) income	\$ (150,710)	\$ 83,666
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Net income from discontinued operations	(3,825)	(34,971)
Loss on early extinguishment of debt	14,258	16,770
Premiums paid on early extinguishment of debt	(12,186)	(13,817)
Cumulative effects of accounting changes, net of tax	187,538	50,593
Depreciation and amortization	65,122	104,199
Provision (benefit) for deferred income taxes	24,528	(8,883)
(Gains) and impairment losses on dispositions, net	28,659	(33,021)
Other non-cash adjustments		667
Change in assets and liabilities, net of effects from acquisitions and dispositions:		
Decrease in receivables	24,912	25,464
Decrease in other assets	33,212	2,106
Increase in payables and other liabilities	8,901	20,772
Net effect of preneed funeral production and maturities	(3,797)	(20,838)
Net effect of cemetery production and deliveries	46,932	(18,112)
Other	337	318
Net cash provided by operating activities from continuing operations	263,881	174,913
Net cash used in operating activities from discontinued operations	(5,344)	(5,378)
Net cash provided by operating activities	258,537	169,535
Cash flows from investing activities:		
Capital expenditures	(72,241)	(67,495)
Proceeds from divestitures and sales of property and equipment	58,122	30,326
Proceeds and distributions from dispositions of businesses, net of cash retained	112,018	330,789
Proceeds from equity investments	39,674	
Payment of purchase obligations to former owners of acquired business		(51,749)
Indemnity payments related to the joint venture of French operations	(1,834)	
Net withdrawals (deposits) of restricted funds and other	13,944	(120,903)
Net cash provided by investing activities from continuing operations	149,683	120,968
Net cash used in investing activities from discontinued operations	(212)	(132)
Net cash provided by investing activities	149,471	120,836

Cash flows from financing activities:

Proceeds from issuance of long-term debt	291,472	241,237
Payments of debt	(8,209)	(124,878)
Early extinguishments of debt	(286,215)	(299,961)
Proceeds from exercise of stock options	5,145	6,040
Purchase of Company common stock	(191,221)	(34,812)
Payments of dividends	(15,184)	
Purchase of subsidiary stock	(844)	
Net cash used in financing activities	(205,056)	(212,374)
Effect of foreign currency	1,322	617
Net increase in cash and cash equivalents	204,274	78,614
Cash and cash equivalents at beginning of period	287,785	239,431
Cash and cash equivalents at end of period	\$ 492,059	\$ 318,045

(See notes to unaudited condensed consolidated financial statements)

Table of Contents

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

(In thousands, except per share amounts)

	Outstanding	Common	Treasury stock, par value	Capital in excess of par value	Unearned Compensation	Accumulated deficit (Restated) note 2	Accumulated other comprehensive (loss) income	Total
Balance at December 31, 2004	323,225	\$ 341,727	\$ (18,502)	\$ 2,395,057	\$ (2,022)	\$ (834,964)	\$ (38,349)	\$ 1,842,947
Net loss						(150,710)		(150,710)
Dividends on common stock (\$.075 per share)				(22,641)				(22,641)
Other comprehensive income:								
Foreign currency translation							6,056	6,056
Reclassification for translation adjustments realized in net loss							101,588	101,588
Total other comprehensive income								107,644
Stock option exercises	1,338	1,338		4,157				5,495
Tax benefit from stock option exercises				1,509				1,509
Restricted stock award	499		499	3,177	(3,676)			
Restricted stock amortization					1,545			1,545
Purchase of Company common stock	(26,914)		(26,914)	(164,307)				(191,221)
	298,148	\$ 343,065	\$ (44,917)	\$ 2,216,952	\$ (4,153)	\$ (985,674)	\$ 69,295	\$ 1,594,568

Balance at
September 30,
2005

(See notes to unaudited condensed consolidated financial statements)

6

Table of Contents

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

1. Nature of Operations

Service Corporation International (SCI or the Company) owns and operates funeral service locations and cemeteries worldwide. The Company also has a minority interest equity investment in funeral operations in France. The Company owns and operates Kenyon International Emergency Services, a disaster response team that engages in mass fatality and emergency response services, which is included in the Company's funeral operations segment.

The funeral service and cemetery operations consist of funeral service locations, cemeteries, crematoria and related businesses. Personnel at the funeral service locations provide all professional services relating to atneed funerals, including the use of funeral facilities and motor vehicles, and preparation and embalming services. Funeral related merchandise (including caskets, burial vaults, cremation receptacles, flowers and other ancillary products and services) is sold at funeral service locations. Certain funeral service locations contain crematoria. The Company sells preneed funeral services whereby a customer contractually agrees to the terms of a funeral to be performed in the future. The Company's cemeteries provide cemetery property interment rights (including mausoleum spaces, lots and lawn crypts) and sell cemetery related merchandise (including stone and bronze memorials, burial vaults, casket and cremation memorialization products) and services (primarily merchandise installations and burial openings and closings). Cemetery items are sold on an atneed or preneed basis. Personnel at cemeteries perform interment services and provide management and maintenance of cemetery grounds. Certain cemeteries operate crematoria, and certain cemeteries contain gardens specifically for the purpose of cremation memorialization.

2. Restatement of Financial Statements

Overview 2006 Restatement

The Company has restated herein its previously issued condensed consolidated statement of operations for the three and nine months ended September 30, 2005 and 2004, its condensed consolidated statement of cash flows for the nine months ended September 30, 2005 and 2004, and its condensed consolidated balance sheet as of September 30, 2005 and December 31, 2004. This restatement corrects errors related to (1) the miscalculation of the Company's actuarially determined pension benefit obligation, (2) the accounting for certain leases related to funeral home properties which were previously accounted for as operating leases, but should have been accounted for as capital leases, and (3) other adjustments identified in a subsequent period but deemed to be not material either individually or in the aggregate. All applicable amounts related to this restatement have been reflected in the Company's condensed consolidated financial statements and disclosed in the notes to the condensed consolidated financial statements in this amended Form 10-Q.

Table of Contents

Pension Benefit Obligation

As previously disclosed in the Company's 2004 Form 10-K, effective January 1, 2004, the Company adopted a new accounting policy related to the accounting for actuarial gains and losses in its pension plan. Under the new accounting policy, the Company began to recognize such actuarial gains and losses in its consolidated statement of operations as they occurred. Previously, the Company amortized the difference between actual and expected investment returns and other actuarial gains and losses over seven years (except to the extent that settlements with employees required earlier recognition). As a result of this accounting change, the Company initially recognized an after tax charge in its 2004 financial statements, representing the cumulative effect of this accounting change, of \$33,599 (\$54,873 before tax). This amount represented the accumulated unrecognized net losses related to the pension plan assets and liabilities as of January 1, 2004.

During the second quarter of 2006, the Company discovered that its actuarially determined pension benefit obligation (PBO) had been incorrectly calculated for the years ended December 31, 2005, 2004, 2003, and 2002 as the impact of pending lump sum cash settlements in the PBO calculation at the end of each respective year had been inadvertently omitted. The net aggregate pre-tax impact of this error over the four-year period ended December 31, 2005 was \$4,233. Had this PBO calculation been correct at the time the Company adopted its new accounting policy effective January 1, 2004, the Company would have recognized an additional cumulative effect of accounting change of \$4,961 (\$3,037 after tax) in its December 31, 2004 consolidated statement of operations, as the vast majority of the impact of previously unrecognized pending lump sum settlements for 2002 and 2003 would have been recognized in connection with the accounting policy change.

Lease Accounting

During the first quarter of 2006, the Company determined that certain of its leases related to funeral home properties that were previously accounted for as operating leases should have been accounted for as capital leases. The aggregate pre-tax adjustment to the Company's previously issued consolidated financial statements is \$2,677, of which \$657 relates to the three-year period ended December 31, 2005. The remaining \$2,020 relates to periods prior to January 1, 2003.

Other Adjustments

The Company has also included other adjustments that were identified in a subsequent period but deemed to be not material, either individually or in the aggregate, and were therefore initially corrected in that subsequent period. Such adjustments impacted the timing of expense items, including income tax expenses previously recognized in the first quarter of 2006. The cumulative amount of such other adjustments was a net aggregate increase to pre-tax income of \$132 and an additional \$389 of income tax expense for the nine months ended September 30, 2005.

Materiality Assessment

The Company evaluated the materiality of these adjustments to its previously issued interim and annual financial statements including its interim financial statements as of and for the three months ended March 31, 2006. The Company determined that the impact of these errors was not material to its previously issued consolidated financial statements; however, the Company has determined that the cumulative correction of the errors in the second quarter of 2006 would have been material to the current period. Therefore, in accordance with paragraph 29 of Accounting Principles Board Opinion No. 28 and the SEC's Staff Accounting Bulletin (SAB) Topic 5-F, the Company is restating its previously issued financial statements to reflect the corrections of the errors in each of the periods affected. As a result, the Company has restated herein its condensed consolidated statements of operations for the three and nine months ended September 30, 2005 and 2004, its condensed consolidated statement of cash flows for the nine months ended September 30, 2005 and 2004, and its condensed consolidated balance sheet at September 30, 2005 and December 31, 2004.

Table of Contents*Overview 2005 Restatement*

The Company had previously restated its consolidated statement of operations for the three and nine months ended September 30, 2004, its consolidated statement of cash flows for the nine months ended September 30, 2004, and its condensed consolidated balance sheet as of December 31, 2004. This restatement corrected errors related to (1) the Company's recognition of income related to its preneed funeral and cemetery trust accounts, (2) preneed funeral trust income that was previously understated as a result of a point-of-sale system error, and (3) the computation of gains and losses on certain asset divestiture activities, including the write-off of certain covenant-not-to-compete agreements which should have been recognized in the Company's 2002 consolidated financial statements.

The Company previously restated its unaudited quarterly financial data for the first three quarters of 2004, as included in its 2004 Form 10-K, for correction of errors related to (1) the recognition of deferred preneed cemetery contract revenues, (2) certain reconciliations of the Company's preneed funeral and cemetery trust assets and deferred revenues, and (3) operating leases and other account reconciliations. At that time, the Company concluded that the net aggregate impact of such errors related to periods prior to January 1, 2004 was not material to its consolidated financial statements or to the first quarter of 2004, nor for any quarterly or annual period prior to January 1, 2004, and as a result, the Company recorded the net aggregate impact of such errors (a \$416 increase to pre-tax income) in *Other operating (expense) income* as a correction of an immaterial error in the first quarter of 2004.

However, in light of the material impact of the errors identified in the second quarter of 2005, as detailed below, the Company concluded that prior period financial statements for the fiscal years ended 2004, 2003, and 2002 should be restated and has corrected such prior periods for the \$416 net impact to *Other operating (expense) income* described above.

Preneed Funeral and Cemetery Trust Verification and Reconciliation Project

During 2003, the Company began implementation of the revised Financial Accounting Standards Board (FASB) Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin (ARB) No. 51 (FIN 46R)*, the preparation for the implementation of Section 404 of the Sarbanes Oxley Act, and the implementation of its new funeral and cemetery point-of-sale system. As a result of these events, the Company began a project to reconcile its preneed funeral and cemetery trust accounts and verify its preneed funeral and preneed cemetery contracts.

The preneed funeral and cemetery trust verification and reconciliation project included three primary components: (1) the reconciliation of assets and deferred revenue related to preneed cemetery merchandise and service trusts; preneed funeral merchandise and service trusts; and cemetery perpetual care trusts, (2) the verification of approximately 430,000 preneed funeral contracts to determine if those contracts were appropriately included in the Company's new point-of-sale system, and (3) the verification of each individual item on each preneed cemetery contract (approximately 3.6 million contract items) to determine if revenue was appropriately recognized at the time of delivery or at the time of service.

As these projects progressed, the Company assessed their status and adjusted the applicable general ledger accounts accordingly. At December 31, 2003, June 30, 2004, and December 31, 2004, the Company made certain adjustments to its consolidated financial statements based on its best estimates at that time. These estimates were based on statistical sampling methods which were influenced by the percentage of reconciliations and verifications completed at the location level and the expected error rate of such uncompleted verifications and reconciliations.

By March 2005, the Company had completed its examination of the 430,000 preneed funeral contracts and had also implemented the reconciliation procedures described above, which resulted in the identification of a significant number of reconciling items. In light of these reconciling items, the Company reevaluated previous adjustments related to these projects and the impact to previously issued financial statements. The Company determined that these adjustments had a material impact on its consolidated financial statements for the first three interim periods of 2004. As a result, the Company restated its unaudited quarterly financial data for the first three interim periods of 2004 in its original 2004 Form 10-K. The Company evaluated the materiality of these adjustments on its consolidated financial statements issued prior to January 1, 2004 and concluded that the impact of these adjustments was not material to the fiscal period ended 2004 or any quarterly or annual period prior to January 1, 2004. As a result, the Company recorded the net aggregate impact of these adjustments (\$416 increase to pretax income) in *Other operating income (expense)*

in its restated first quarter 2004 financial statements as a correction of an error.

During the first and second quarters of 2005, the Company continued to find and record these reconciling items to its trust asset and deferred revenue detailed records. During the second quarter of 2005, the Company determined that certain of the reconciling items had been reflected improperly in its initial reconciliation process at December 31, 2004 which resulted in the identification of errors to the Company's consolidated financial statements. The Company recorded a \$1,600 charge in its first quarter 2005 consolidated financial statements for similar prior period adjustments arising from the aforementioned reconciliation process.

Also during the second quarter of 2005, the Company identified other adjustments, one of which related to a point-of-sale system error that caused preneed funeral trust income accounts to be understated in the fourth quarter of 2004 and the first quarter of 2005 by \$1,570 and \$2,700, respectively, and another of which related to the recognition of a loss on a disposition recorded in April 2005 that should have been recognized in the Company's first quarter 2005 unaudited consolidated financial statements. In addition, in connection with the asset divestitures, the Company failed to write off certain covenant-not-to-compete agreements. These write-offs should have been recorded in the Company's 2002 consolidated financial statements.

Additionally, the Company adjusted its method of accounting for certain types of operating leases related primarily to the Company's funeral home properties. Historically, the Company recorded operating lease expense, related primarily to funeral home properties, over the initial lease term without regard to reasonably assured renewal options or fixed escalation provisions. The Company now calculates its straight line operating lease expense over the lease term (including certain renewal options and fixed escalation provisions, to the extent necessary) in accordance with SFAS 13, *Accounting for Leases*.

Materiality Assessment

The Company evaluated the materiality of these adjustments (including the \$1,600 charge recorded in the first quarter of 2005 and the adjustments aggregating to \$416 associated with the restatement of the first three interim periods of 2004 described above) on its consolidated financial statements for the second quarter of 2005, its unaudited quarterly financial statements for 2004 and 2003, and its consolidated financial statements for each of the five prior annual periods ended December 31, 2004. The Company determined that the net effect of these adjustments (\$5,192 charge to pretax income), which primarily related to periods prior to 2000, was not material to the Company's previously reported consolidated financial statements for periods described above; however, the Company determined that such impact was material to the Company's second quarter 2005 consolidated financial statements. As a result, the Company restated its consolidated statements of operations for the three and nine months ended September 30, 2004, its consolidated statement of cash flows for the nine months ended September 30, 2004, and its consolidated balance sheet at December 31, 2004.

Table of Contents

The effect of the adjustments to the Company's condensed consolidated statement of operations for the three and nine months ended September 30, 2005 and 2004 is as follows (in thousands, except per share data):

	Three months ended September 30, 2005		Three months ended September 30, 2004		
	As		As		As
	Previously Reported (unaudited)	As Restated (unaudited)	Originally Reported (unaudited)	As Restated (unaudited)	Further Restated (unaudited)
Revenues	\$ 406,369	\$ 406,369	\$ 397,012	\$ 397,186	\$ 397,186
Costs and expenses	(348,094)	(347,526)	(328,932)	(328,891)	(328,519)
Gross profit	58,275	58,843	68,080	68,295	68,667
General and administrative expense	(19,753)	(19,744)	(25,298)	(25,298)	(25,295)
Operating income	11,076	11,653	39,501	39,716	40,091
Interest expense	(25,821)	(26,170)	(26,609)	(26,609)	(26,955)
(Loss) income from continuing operations before income taxes	(10,302)	(10,074)	17,147	17,362	17,391
Benefit (provision) for income taxes	1,131	885	(4,256)	(4,336)	(4,526)
Net (loss) income	\$ (9,634)	\$ (9,652)	\$ 13,741	\$ 13,876	\$ 13,715
Earnings per share:					
Basic	\$ (.03)	\$ (.03)	\$.04	\$.04	\$.04
Diluted	\$ (.03)	\$ (.03)	\$.04	\$.04	\$.04

	Nine months ended September 30, 2005		Nine months ended September 30, 2004		
	As		As		As
	Previously Reported (unaudited)	As Restated (unaudited)	Originally Reported (unaudited)	As Restated (unaudited)	Further Restated (unaudited)
Revenues	\$ 1,285,521	\$ 1,285,653	\$ 1,404,881	\$ 1,404,597	\$ 1,404,597
Costs and expenses	(1,057,676)	(1,055,966)	(1,150,403)	(1,150,284)	(1,149,170)
Gross profit	227,845	229,687	254,478	254,313	255,427
General and administrative expense	(61,963)	(61,936)	(100,347)	(100,347)	(100,338)
Gains and impairment (losses) and dispositions, net	(28,659)	(28,659)	33,018	33,021	33,021
Operating income	137,223	139,092	187,565	186,987	188,110
Interest expense	(76,352)	(77,399)	(91,110)	(91,110)	(92,147)
(Loss) income from continuing operations before income taxes and cumulative effect of accounting changes	58,369	59,191	92,950	92,372	92,458
Benefit (provision) for income taxes	(25,531)	(26,188)	6,966	7,177	6,830
(Loss) income from continuing operations before cumulative effect of accounting changes	32,838	33,003	99,916	99,549	99,288
Cumulative effect of accounting changes	(187,538)	(187,538)	(47,074)	(47,556)	(50,593)

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q/A

Net (loss) income	\$ (150,875)	\$ (150,710)	\$ 87,813	\$ 86,964	\$ 83,666
Earnings per share:					
Basic	\$ (.50)	\$ (.50)	\$.28	\$.28	\$.27
Diluted	\$ (.49)	\$ (.49)	\$.27	\$.27	\$.26

The effect of the restatement on the Company's previously reported consolidated balance sheet as of September 30, 2005 and December 31, 2004 is as follows:

	September 30, 2005		December 31, 2004		
	As	As	As	As	As
	Previously Reported (unaudited)	As Restated (unaudited)	Originally Reported	As Restated	Further Restated
Selected condensed consolidated balance sheet data:					
Receivables, net of allowances	\$ 82,306	\$ 82,306	\$ 102,156	\$ 102,622	\$ 102,622
Total current assets	\$ 708,551	\$ 708,551	\$ 533,497	\$ 533,963	\$ 533,963
Preferred funeral receivables and trust investments	\$1,238,123	\$1,238,123	\$1,264,600	\$1,267,784	\$1,267,784
Preferred cemetery receivables and trust investments	\$1,295,352	\$1,295,352	\$1,402,750	\$1,399,778	\$1,399,778
Property and equipment, at cost, net	\$ 947,024	\$ 955,078	\$ 970,547	\$ 970,547	\$ 978,861
Deferred charges and other assets	\$ 247,327	\$ 259,375	\$ 618,565	\$ 631,839	\$ 631,839
Total assets	\$7,701,966	\$7,724,961	\$8,199,196	\$8,218,840	\$8,227,154
Accounts payable and accrued liabilities	\$ 234,281	\$ 233,634	\$ 221,877	\$ 221,877	\$ 221,235
Current maturities of long-term debt	\$ 88,272	\$ 91,379	\$ 75,075	\$ 77,950	\$ 78,164
Long-term debt	\$1,172,513	\$1,195,535	\$1,178,885	\$1,189,163	\$1,200,353
Deferred preneed funeral revenues	\$ 558,381	\$ 558,381	\$ 486,191	\$ 498,571	\$ 498,571
Deferred preneed cemetery revenues	\$ 789,143	\$ 789,143	\$ 801,065	\$ 803,144	\$ 803,144
Deferred income taxes	\$ 174,053	\$ 172,601	\$ 279,474	\$ 276,572	\$ 274,463
Other liabilities	\$ 381,346	\$ 385,866	\$ 429,103	\$ 431,917	\$ 437,298
Non-controlling interest in funeral and cemetery trusts	\$1,973,091	\$1,973,091	\$2,095,852	\$2,092,881	\$2,092,881
Accumulated deficit	\$ 980,119	\$ 985,674	\$ 824,364	\$ 829,244	\$ 834,964
Stockholders' equity	\$1,600,123	\$1,594,568	\$1,853,576	\$1,848,667	\$1,842,947
Total liabilities and stockholders' equity	\$7,701,966	\$7,724,961	\$8,199,196	\$8,218,840	\$8,227,154

The effect of the restatement on the Company's previously reported condensed consolidated statement of cash flows for the nine months ended September 30, 2005 and 2004 is as follows:

	Nine months ended September 30, 2005		Nine months ended September 30, 2004	
	As	As	As	As
	Previously Reported (unaudited)	As Restated (unaudited)	Previously Reported (unaudited)	As Restated (unaudited)
Net cash provided by operating activities	\$ 258,386	\$ 258,537	\$ 169,409	\$ 169,535
Net cash used in financing activities	\$(204,905)	\$(205,056)	\$(212,248)	\$(212,374)

We have also reflected the effects of this restatement in notes three, four, five, six, seven, eight, ten, eleven, and twelve to these condensed consolidated financial statements.

Table of Contents**3. Summary of Significant Accounting Policies***Principles of Consolidation and Basis of Presentation*

The consolidated financial statements for the three and nine months ended September 30, 2005 and 2004 include the accounts of the Company and all majority-owned subsidiaries and are unaudited but include all adjustments, consisting of normal recurring accruals and any other adjustments, which management considers necessary for a fair presentation of the results for these periods. These consolidated financial statements have been prepared in a manner consistent with the accounting policies described in the Company's amended Annual Report on Form 10-K (Amendment No. 2) for the year ended December 31, 2004, unless otherwise disclosed herein, and should be read in conjunction therewith. The accompanying year-end consolidated balance sheet was derived from the audited consolidated financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year period.

The Company has reclassified certain prior year amounts to conform to the current period financial presentation with no effect on previously reported results of operations, financial condition or cash flows.

Use of Estimates in the Preparation of Financial Statements

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

Stock Options

The Company accounts for employee stock-based compensation expense under the intrinsic value method. Under this method, no compensation expense is recognized on stock options if the grant price equals the market value on the date of grant.

If the Company had elected to recognize compensation expense for its option plans based on the fair value method, net (loss) income and per share amounts would have changed to the pro forma amounts indicated below.

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2005	2004	2005	2004
	(Restated)	(Restated)	(Restated)	(Restated)
	note 2	note 2	note 2	note 2
Net (loss) income	\$ (9,652)	\$ 13,715	\$ (150,710)	\$ 83,666
Deduct: Total additional stock-based employee compensation expense determined under fair value based method for all awards, net of related tax expense	(391)	(806)	(1,174)	(2,407)
Pro forma net (loss) income	\$ (10,043)	\$ 12,909	\$ (151,884)	\$ 81,259
Basic (loss) earnings per share:				
Net (loss) income	\$ (.03)	\$.04	\$ (.50)	\$.27
Deduct: Total additional stock-based employee compensation expense determined under fair value based method for all awards, net of related tax expense				(.01)
Pro forma basic (loss) earnings per share	\$ (.03)	\$.04	\$ (.50)	\$.26

Diluted (loss) earnings per share:

Net (loss) earnings	\$	(.03)	\$	.04	\$	(.49)	\$	.26
Deduct: Total additional stock-based employee compensation expense determined under fair value based method for all awards, net of related tax expense								(.01)
Pro forma diluted (loss) earnings per share	\$	(.03)	\$	.04	\$	(.49)	\$	.25

The fair value of the Company's stock options used to compute the pro forma net (loss) income and per share disclosures is determined by calculating the estimated fair value at grant date using the Black-Scholes option-pricing model.

The Company currently computes stock-based compensation cost for employees eligible to retire over the three-year standard vesting period of the grants. Upon adoption of SFAS 123R, the Company will amortize new option grants to such retirement-eligible employees over a shorter period, consistent with the retirement vesting acceleration provisions of these grants. If the Company had historically computed stock-based compensation cost for these employees under this accelerated method, \$549 or less than \$.01 per diluted share of after-tax compensation cost would have been accelerated and cumulatively included in the pro forma expense above through September 30, 2005. The tax benefit associated with the additional compensation expense discussed above would have been \$211 and \$632 for the three and nine months ended September 30, 2005 and \$474 and \$1,419 for the three and nine months ended September 30, 2004, respectively.

Income Taxes

The Company reported an income tax benefit of 8.8% in the three months ended September 30, 2005 compared to a provision of 26.0% in the three months ended September 30, 2004. For the nine months ended September 30, 2005 and 2004, the Company reported an income tax provision of 44.2% and an income tax benefit of 7.4%, respectively.

The tax rates in 2005 were impacted by permanent differences between book and tax bases of North American asset dispositions. The tax rates in 2004 are due to non-cash tax benefits recognized from the disposition of the Company's French operations consummated in the first quarter of 2004 and the sale of the Company's equity investment in a United Kingdom company in the second quarter of 2004. For more information regarding these transactions, see note twelve to the condensed consolidated financial statements.

4. Accounting Changes and New Accounting Pronouncements

Accounting Changes and Error Corrections

In May 2005, the FASB issued Statement No. 154, *Accounting Changes and Error Corrections - A Replacement of APB Opinion No. 20 and FASB Statement No. 3* (SFAS 154). SFAS 154 primarily requires retrospective application to prior period financial statements for the direct effects of changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

Deferred Selling Costs

Effective January 1, 2005, the Company changed its method of accounting for direct selling costs related to the acquisition of preneed funeral and preneed cemetery contracts. Prior to this change, the Company capitalized such direct selling costs and amortized these deferred selling costs in proportion to the revenue recognized. Under the new method of accounting, the Company expenses these direct selling costs as incurred. The Company believes the new method is preferable because it better reflects the economics of the Company's business.

Table of Contents

As of January 1, 2005, the Company recorded a cumulative effect of \$187,538, net of tax of \$117,428. This amount represents the cumulative balance of deferred selling costs recorded on the Company's consolidated balance sheet in *Deferred charges and other assets* at the time of the accounting change. If the Company had not changed its method of accounting for direct selling costs as described above, net income for the three months ended September 30, 2005 would have been approximately \$3,582, or \$.01 per basic and diluted share higher than currently reported. If the Company had not changed its method of accounting for direct selling costs as described above, net income for the nine months ended September 30, 2005 would have been approximately \$8,472, or \$.03 per basic and diluted share higher than currently reported.

The three and nine months ended September 30, 2004 pro forma amounts in the table below reflect the new policy to expense selling costs as incurred. The effect of the change for the three and nine months ended September 30, 2004 would have decreased net income from continuing operations before cumulative effects of accounting changes by approximately \$3,073 and \$9,956, or \$.01 and \$.03 per diluted share, respectively.

	Three months ended September 30, 2004			Nine months ended September 30, 2004		
	Historical (Restated) note 2	Deferred Selling Costs, net (1)	Pro forma (Restated) note 2	Historical (Restated) note 2	Deferred Selling Costs, net (1)	Pro forma (Restated) note 2
Gross profit:						
Funeral	\$ 45,068	\$ (905)	\$ 44,163	\$ 182,638	\$ (3,574)	\$ 179,064
Cemetery	23,599	(4,114)	19,485	72,789	(12,686)	60,103
	68,667	(5,019)	63,648	255,427	(16,260)	239,167
Income (loss) from continuing operations before income taxes and cumulative effects of accounting changes	\$ 17,391	\$ (5,019)	\$ 12,372	\$ 92,458	\$ (16,260)	\$ 76,198
Net income (loss)	13,715	\$ (3,073)	\$ 10,642	\$ 83,666	\$ (9,956)	\$ 73,710
Amounts per common share:						
Net income (loss) basic	\$.04	\$ (.01)	\$.03	\$.27	\$ (.04)	\$.23
Net income (loss) diluted	\$.04	\$ (.01)	\$.03	\$.26	\$ (.03)	\$.23

(1) Represents net deferred selling costs that would have been expensed under the new method of accounting adopted on January 1, 2005.

Other-Than-Temporary Impairments

In June 2005, the FASB decided not to provide additional guidance on the meaning of other-than-temporary impairment, and directed the staff to issue proposed FSP EITF 03-1-a, *Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1*, as final. The final FSP supersedes EITF Issued No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, and EITF Topic No. D-44, *Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value*. The final FSP (retitled FSP FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*) replaces the guidance set forth in paragraphs 10-18 of EITF Issue 03-1 with references to existing other-than-temporary impairment guidance. FSP FAS 115-1 codifies the guidance set forth in EITF Topic D-44 and clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other-than-temporary, even if a decision to sell has not been made. FSP FAS 115-1 is effective for other-than-temporary analysis conducted in periods beginning after December 15, 2005. The Company has adopted the provisions of FSP FAS 115-1 and as of the date of adoption, this Statement has had no material impact on its consolidated financial statements, results of operations, financial position, or cash flows.

Inventory Costs

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs an amendment of ARB 43, Chapter 4* (SFAS 151). SFAS 151 amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4, *Inventory Pricing*, to clarify the

Table of Contents

accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. SFAS 151 requires that those items be recognized as current-period charges, rather than as a portion of the inventory cost. In addition, SFAS 151 requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect this statement to have a material impact on its consolidated financial statements, results of operations, financial position, or cash flows.

Share-Based Payment

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment* (SFAS 123R). SFAS 123R is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. Among other items, SFAS 123R eliminates the use of the intrinsic value method of accounting, and requires companies to recognize the cost of employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements. The effective date of SFAS 123R is the first annual reporting period beginning after June 15, 2005, which is the first quarter of 2006 for the Company.

The Company currently uses the intrinsic value method to account for stock options. For disclosure purposes, the Company currently utilizes a standard option pricing model (i.e., Black-Scholes) to measure the fair value of stock options granted to employees. The Company will continue to utilize the Black-Scholes option pricing model to measure the fair value of its stock options. The Company expects to adopt SFAS 123R effective January 1, 2006. The Company is currently evaluating the impact that this adoption will have on its results of operations.

Variable Interest Entities

In January 2003, the FASB issued FIN 46. This interpretation clarifies the application of ARB No. 51, *Consolidated Financial Statements*, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. In December 2003, the FASB revised FIN 46.

Under the provisions of FIN 46R, the Company is required to consolidate certain cemeteries and trust assets. Merchandise and service trusts and cemetery perpetual care trusts are considered variable interest entities because the trusts meet the conditions of paragraphs 5(a) and 5(b)(1) of FIN 46R. That is, as a group, the equity investors (if any) do not have sufficient equity at risk and do not have the direct or indirect ability through voting or similar rights to make decisions about the trusts' activities that have a significant effect on the success of the trusts. FIN 46R requires the Company to consolidate merchandise and service trusts and cemetery perpetual care trusts for which the Company is the primary beneficiary (i.e., those for which the Company absorbs a majority of the trusts' expected losses). The Company is the primary beneficiary of a trust whenever a majority of the assets of the trust are attributable to deposits of customers of the Company.

Consolidation of Trusts: The Company implemented FIN 46R as of March 31, 2004, which resulted in the consolidation of the Company's preneed funeral and cemetery merchandise and service trust assets and the Company's cemetery perpetual care trusts. No cumulative effect of an accounting change was recognized by the Company as a result of the implementation of FIN 46R as it relates to the consolidation of the trusts. The implementation of FIN 46R affects certain line items on the Company's consolidated balance sheet and statement of operations as described below; however, as it relates to the consolidation of trusts, there is no impact to net income in the statement of operations as a result of the implementation. Additionally, the implementation of FIN 46R did not result in any net changes to the Company's consolidated statement of cash flows; however, it does require certain financing and investing activities to be disclosed.

Although FIN 46R requires consolidation of most of the merchandise and service and perpetual care trusts, it does not change the legal relationships among the trusts, the Company and its customers. In the case of merchandise and service trusts, the customers are the legal beneficiaries. In the case of cemetery perpetual care trusts, the Company does not have a legal right to the perpetual care trust assets. For these reasons, upon consolidation of the trusts, the Company recognizes non-controlling interests in its financial statements to reflect third party interests in these trusts in accordance with FASB Statement No. 150, *Accounting for Certain Financial*

Table of Contents

Instruments with Characteristics of Both Liability and Equity (SFAS 150). The Company classifies deposits to merchandise and service trusts as non-controlling liability interests and classifies deposits to cemetery perpetual care trusts as non-controlling equity interests.

The Company records cash received from customers that is payable to the trusts but not yet required to be deposited in the trusts as restricted cash in *Deferred charges and other assets* in its consolidated balance sheet. At September 30, 2005 and December 31, 2004, these pending deposits totaled \$10,668 and \$11,218, respectively. The Company continues to account for amounts received from customers prior to delivery of merchandise or services that are not required to be deposited in merchandise and service trusts as deferred revenue.

Beginning March 31, 2004, the Company recognizes net realized investment earnings of the merchandise and service trusts and perpetual care trusts, as well as the related trustee investment expenses and taxes, within *Other income, net*. The Company then recognizes a corresponding expense within *Other income, net* representing the net realized earnings of those trusts that are attributable to the non-controlling interest holders. The corresponding credit for this expense is reflected in the Company's consolidated balance sheet in *Non-controlling interest in funeral and cemetery trusts* for merchandise and service trusts or *Non-controlling interest in perpetual care trusts* for cemetery perpetual care trusts. The sum of these expenses recorded in *Other income, net* offsets the net realized earnings of such trusts also recognized within *Other income, net*. Accordingly, the Company's net income in the consolidated statement of operations is not affected by consolidation of the trusts in accordance with FIN 46R.

To the extent the earnings of the trusts are distributed prior to the delivery of merchandise and/or services, a corresponding amount of non-controlling interest is reclassified to deferred revenue until the amounts qualify for revenue recognition. In the case of merchandise and service trusts, the Company recognizes as revenues amounts previously attributed to non-controlling interests and deferred revenues upon the performance of services and delivery of merchandise, including earnings accumulated in these trusts. In the case of the cemetery perpetual care trusts, distributable earnings are recognized in cemetery revenues to the extent of qualifying cemetery maintenance costs.

Prior to the implementation of FIN 46R and the consolidation of the trusts, funds received from customers and deposited into merchandise and service trusts until maturity of the preneed contract were recorded as receivables due from trust assets. Upon implementation of FIN 46R, the Company replaced receivables due from trust assets with the trust assets, at market.

An allowance for contract cancellation is provided based on historical experience. An allowance is no longer provided on the funds associated with the preneed contracts that are held in trust, currently recorded as trust assets, but previously recorded as receivables due from trust assets. As such, the amount has decreased since the implementation of FIN 46R.

Both the merchandise and services trusts and the cemetery perpetual care trusts hold investments in marketable securities that are classified as available-for-sale by the Company under the requirements of SFAS No. 115,

Accounting for Certain Investments in Debt and Equity Securities (SFAS 115). In accordance with SFAS 115, available-for-sale securities of the trusts are recorded at fair value, with unrealized gains and losses excluded from earnings and initially recorded as a component of *Accumulated other comprehensive income (loss)* in the Company's consolidated balance sheet. Using the guidance in EITF Topic D-41, *Adjustments in Assets and Liabilities for Holding Gains and Losses as Related to the Implementation of FASB Statement No. 115* (Topic D-41), unrealized gains and losses on available-for-sale securities of the trusts attributable to the non-controlling interest holders are not recorded as *Accumulated other comprehensive income (loss)*, but are recorded as an adjustment to either *Non-controlling interest in funeral and cemetery trusts* or *Non-controlling interest in perpetual care trusts*. Therefore, unrealized gains and losses attributable to the non-controlling interest holders are reclassified from *Accumulated other comprehensive income (loss)* to either *Non-controlling interest in funeral and cemetery trusts* or *Non-controlling interest in perpetual care trusts*. The gross effect from applying Topic D-41 on the Company's *Accumulated other comprehensive income (loss)* is disclosed in note eleven of the consolidated financial statements. However, the Company's *Accumulated other comprehensive income (loss)* balance on the face of the balance sheet is ultimately not affected by consolidation of the trusts.

Table of Contents

Consolidation of Certain Cemeteries: Prior to December 31, 2003, the Company operated certain cemeteries in Michigan which the Company managed but did not own. During the Company's evaluation of FIN 46R, the Company evaluated these cemeteries to determine whether such cemeteries were within the scope of FIN 46R. The investment capital of these cemeteries was financed by the Company in exchange for a long-term sales, accounting, and cash management agreement. In accordance with this agreement, the Company receives the majority of the cash flows from these cemeteries. Additionally, the Company absorbs the majority of these cemeteries' expected losses and receives a majority of the cemeteries' residual returns. As a result, the Company concluded that it was the primary beneficiary of these cemeteries and that the long-term sales, accounting, and cash management agreement is a variable interest as defined by FIN 46R. Given the circumstances above, the Company consolidated such cemeteries at March 31, 2004. The Company recognized an after tax charge of \$13,957, representing the cumulative effect of an accounting change, as a result of consolidating these cemeteries. The results of operations and cash flows of these cemeteries are included in the Company's consolidated statements of operations and cash flows beginning March 31, 2004. Excluding the cumulative effect of accounting change, the effect of consolidating these entities did not have a significant impact on the Company's reported results of operations.

Pension Plans

Effective January 1, 2004, the Company changed its accounting for gains and losses on its pension plan assets and obligations. The Company now recognizes such gains and losses in its consolidated statement of operations as such gains and losses are incurred. Prior to January 1, 2004, the Company amortized the difference between actual and expected investment returns and actuarial gains and losses over seven years (except to the extent that settlements with employees required earlier recognition). The Company believes the new method of accounting better reflects the economic nature of the Company's pension plans and recognizes gains and losses on the pension plan assets and liabilities in the year the gains or losses occur. As a result of this accounting change, the Company recognized a charge for the cumulative effect of an accounting change of \$36,636 (net of tax) as of January 1, 2004. This amount represents accumulated unrecognized net losses related to the pension plan assets and liabilities. In addition, for interim periods, the Company records net pension expense or income reflecting estimated returns on plan assets and obligations. The Company will recognize actual gains and losses on plan assets and obligations as actuarial information becomes available upon review of the annual remeasurement.

5. Debt

Debt was as follows:

	September 30, 2005	December 31, 2004
	(Restated)	(Restated)
	note 2	note 2
6.0% notes due December 2005	\$ 63,497	\$ 63,801
7.2% notes due June 2006	10,698	150,000
6.875% notes due October 2007	13,497	143,475
6.5% notes due March 2008	195,000	195,000
7.7% notes due April 2009	341,635	358,266
7.875% debentures due February 2013	55,627	55,627
6.75% notes due April 2016	250,000	250,000
7.0% notes due June 2017	300,000	
Convertible debentures, maturities through 2013, fixed interest rates from 4.75% to 5.5%, conversion prices from \$13.02 to \$50.00 per share	28,327	30,375
Mortgage notes and other debt, maturities through 2050	54,044	60,076
Unamortized pricing discounts and other	(25,411)	(28,103)
Total debt	1,286,914	1,278,517

Less current maturities		(91,379)		(78,164)
Total long-term debt		\$ 1,195,535	\$	1,200,353

Table of Contents

The Company's consolidated debt had a weighted average interest rate of 7.05% at September 30, 2005 and 7.07% at December 31, 2004. Approximately 99% of the total debt had a fixed interest rate at September 30, 2005 and December 31, 2004.

Bank Credit Agreements

The Company's bank credit agreement, which was executed on August 11, 2004, and matures in August of 2007, provides a total lending commitment of \$200,000, including a sub-limit of \$175,000 for letters of credit. As of September 30, 2005, the Company has no cash borrowings outstanding under this credit facility, but has used the facility to support \$59,794 of letters of credit. This bank credit facility is secured by the stock of the Company's domestic subsidiaries and these domestic subsidiaries have guaranteed the Company's indebtedness associated with this facility. The subsidiary guarantee is a guarantee of payment of the outstanding amount of the total lending commitment. It covers the term of the agreement, including extensions and totaled a maximum potential amount of \$59,794 and \$66,985 at September 30, 2005 and December 31, 2004, respectively. The facility contains certain financial covenants, including a minimum interest coverage ratio, a maximum leverage ratio, maximum capital expenditure limitations, minimum net worth requirements and certain cash distribution restrictions. Interest rates for the outstanding borrowings will be based on various indices as determined by the Company. The Company also pays a quarterly fee on the unused commitment, which ranges from 0.25% to 0.50%.

Debt Extinguishment, Reductions and Additions

In the first quarter of 2005, the Company purchased \$7,131 aggregate principal amount of its 7.70% notes due 2009 in the open market. As a result of this transaction, the Company recognized a loss of \$1,207 recorded in *Loss on early extinguishment of debt*, in its consolidated statement of operations. In the second quarter of 2005, the Company purchased an additional \$9,500 aggregate principal amount of its 7.70% notes due 2009, and \$304 aggregate principal amount of its 6.00% notes due 2005 in the open market. Also in the second quarter of 2005, the Company redeemed \$129,978 aggregate principal amount of its 6.875% notes due 2007 and \$139,302 aggregate principal amount of its 7.20% notes due 2006 pursuant to a tender offer for such notes. As a result of these second quarter 2005 transactions, the Company incurred a loss of \$13,051 recorded in *Loss on early extinguishment of debt*, which is comprised of the redemption premiums paid of \$12,186 and the write-off of unamortized debt issuance costs of \$2,072.

On June 15, 2005, the Company issued \$300,000 in an unregistered offering of senior unsecured 7.00% notes due June 15, 2017, which pay interest semi-annually beginning December 15, 2005. The Company used the net proceeds, together with available cash, to purchase existing indebtedness pursuant to the tender offer described in the previous paragraph. The notes are subject to the provisions of the Company's Senior Indenture dated as of February 1, 1993, as amended, which includes certain covenants limiting, among other things, the creation of liens securing indebtedness and sale-leaseback transactions. The Company is entitled to redeem the notes at any time by paying a make-whole premium. Under the terms of the issuance of the unregistered notes, the Company has an obligation to register the notes with the Securities and Exchange Commission (SEC). Because the Company did not file the related SEC registration statement within the required time period, it incurred an aggregate incremental interest expense of \$31 in the third quarter of 2005.

Additional Debt Disclosures

At September 30, 2005 and December 31, 2004, the Company had deposited \$11,746 and \$26,707, respectively, in restricted, interest-bearing accounts that were pledged as collateral for various credit instruments and commercial commitments. This restricted cash is included in *Deferred charges and other assets* in the consolidated balance sheet.

Table of Contents**6. Retirement Plans**

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2005	2004	2005	2004
	(Restated)	(Restated)	(Restated)	(Restated)
	note 2	note 2	note 2	note 2
Interest cost on projected benefit obligation	\$ 2,028	\$ 2,281	\$ 6,083	\$ 6,843
Actual return on plan assets	(1,807)	(2,672)	(5,420)	(8,018)
Amortization of prior service cost	46	47	138	137
Recognized net actuarial loss (gain) and trust related expenses	1,078	(2,392)	3,593	(864)
	\$ 1,345	\$ (2,737)	\$ 4,394	\$ (1,902)

Effective January 1, 2001, the Company curtailed its US Pension Plan, SERP, Senior SERP and Directors' Plan. As these plans have been frozen, the participants do not earn additional benefit from additional years of service and the Company has not incurred service costs subsequent to 2000.

7. Segment Reporting

The Company's operations are both product based and geographically based, and the reportable operating segments presented below include the Company's funeral and cemetery operations. The Company's geographic areas include North America and Other Foreign.

In 2005, Other Foreign consists of the Company's operations in Singapore and Germany. In 2004, Other Foreign also included operations in France, which were disposed of in the first quarter of 2004. Results from the Company's funeral and cemetery businesses in Argentina and Uruguay, which were sold in the first quarter of 2005, and its cemetery business in Chile, which was sold in the third quarter of 2005, are classified as discontinued operations for all periods. The Company conducts both funeral and cemetery operations in North America and funeral operations in Other Foreign geographic areas.

The Company's reportable segment information is as follows:

	Funeral	Cemetery	Reportable
	(Restated)	(Restated)	segments
	note 2	note 2	(Restated)
			note 2
Revenues from external customers:			
Three months ended September 30,			
2005	\$ 262,665	\$ 143,704	\$ 406,369
2004	\$ 266,704	\$ 130,482	\$ 397,186
Nine months ended September 30,			
2005	\$ 866,705	\$ 418,948	\$ 1,285,653
2004	\$ 980,716	\$ 423,881	\$ 1,404,597
Gross profit:			
Three months ended September 30,			
2005	\$ 36,043	\$ 22,800	\$ 58,843
2004	\$ 45,068	\$ 23,599	\$ 68,667
Nine months ended September 30,			

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q/A

2005	\$ 166,878	\$ 62,809	\$ 229,687
2004	\$ 182,638	\$ 72,789	\$ 255,427

17

Table of Contents

The following table reconciles gross profit from reportable segments to the Company's consolidated income from continuing operations before income taxes and cumulative effects of accounting changes:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2005	2004	2005	2004
	(Restated)	(Restated)	(Restated)	(Restated)
	note 2	note 2	note 2	note 2
Gross profit from reportable segments	\$ 58,843	\$ 68,667	\$ 229,687	\$ 255,427
General and administrative expenses	(19,744)	(25,295)	(61,936)	(100,338)
Gains and impairment (losses) on dispositions, net	(27,446)	(3,281)	(28,659)	33,021
Operating income	11,653	40,091	139,092	188,110
Interest expense	(26,170)	(26,955)	(77,399)	(92,147)
Loss on early extinguishment of debt			(14,258)	(16,770)
Other income, net	4,443	4,255	11,756	13,265
(Loss) income from continuing operations before income taxes and cumulative effects of accounting changes	\$ (10,074)	\$ 17,391	\$ 59,191	\$ 92,458

The Company's geographic area information is as follows:

	North	Other	Total
	America	Foreign	Total
	(Restated)		(Restated)
	note 2		note 2
Revenues from external customers:			
Three months ended September 30,			
2005	\$ 403,579	\$ 2,790	\$ 406,369
2004	\$ 393,432	\$ 3,754	\$ 397,186
Nine months ended September 30,			
2005	\$ 1,276,832	\$ 8,821	\$ 1,285,653
2004	\$ 1,267,391	\$ 137,206	\$ 1,404,597
Gains and impairment (losses) on dispositions, net:			
Three months ended September 30,			
2005	\$ (27,446)	\$	\$ (27,446)
2004	\$ (3,476)	\$ 195	\$ (3,281)
Nine months ended September 30,			
2005	\$ (28,659)	\$	\$ (28,659)
2004	\$ 32,929	\$ 92	\$ 33,021
Operating income:			
Three months ended September 30,			
2005	\$ 11,588	\$ 65	\$ 11,653
2004	\$ 39,261	\$ 830	\$ 40,091
Nine months ended September 30,			

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q/A

2005	\$ 138,303	\$ 789	\$ 139,092
2004	\$ 174,789	\$ 13,321	\$ 188,110
Depreciation and amortization:			
Three months ended September 30,			
2005	\$ 22,419	\$ 194	\$ 22,613
2004	\$ 32,601	\$ 244	\$ 32,845
Nine months ended September 30,			
2005	\$ 64,806	\$ 316	\$ 65,122
2004	\$ 103,141	\$ 1,058	\$ 104,199
Total assets at:			
September 30, 2005	\$ 7,713,038	\$ 11,923	\$ 7,724,961
December 31, 2004	\$ 8,069,804	\$ 157,350	\$ 8,227,154

Table of Contents

Included in the North America figures above are the following United States amounts:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2005	2004	2005	2004
	(Restated)	(Restated)	(Restated)	(Restated)
	note 2	note 2	note 2	note 2
Revenues from external customers	\$ 376,530	\$ 372,365	\$ 1,196,374	\$ 1,196,071
Operating income	\$ 6,471	\$ 35,962	\$ 120,198	\$ 157,940
Depreciation and amortization	\$ 21,219	\$ 31,025	\$ 61,252	\$ 97,448
Total assets (a)	\$ 7,301,135	\$ 7,692,638	\$ 7,301,135	\$ 7,692,638

(a) Prior year amounts are as of December 31, 2004.

Included in the Other Foreign figures above are the following France amounts:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2005	2004	2005	2004
Revenues from external customers	\$	\$	\$	\$ 127,282
Operating income	\$	\$	\$	\$ 11,664

The changes in the carrying amounts of goodwill for the Company's two reportable segments are as follows:

	Funeral	Cemetery	Total
Balance as of December 31, 2004	\$ 1,166,657	\$ 2,383	\$ 1,169,040
Dispositions	(29,627)	(2,507)	(32,134)
Effects of foreign currency and other	3,479	124	3,603
Balance as of September 30, 2005	\$ 1,140,509	\$	\$ 1,140,509

Table of Contents**8. Supplementary Information**

The detail of certain income statement accounts is as follows for the three and nine months ended September 30:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2005	2004	2005	2004
	(Restated)	(Restated)	(Restated)	(Restated)
	note 2	note 2	note 2	note 2
North America goods and services revenues				
Goods				
Funeral	\$ 113,965	\$ 120,805	\$ 380,149	\$ 379,363
Cemetery	97,351	85,884	283,508	287,524
Total goods	211,316	206,689	663,657	666,887
Services				
Funeral	138,899	135,228	456,369	441,543
Cemetery	37,797	34,046	108,785	104,347
Total services	176,696	169,274	565,154	545,890
North America goods and services revenues	388,012	375,963	1,228,811	1,212,777
International revenues	2,790	3,754	8,821	137,206
Other revenues	15,567	17,469	48,021	54,614
Total revenues	\$ 406,369	\$ 397,186	\$ 1,285,653	\$ 1,404,597
North America goods and services costs				
Goods				
Funeral	\$ 71,039	\$ 70,907	\$ 223,583	\$ 219,853
Cemetery	41,138	30,239	120,418	117,372
Total cost of goods	112,177	101,146	344,001	337,225
Services				
Funeral	63,217	59,902	200,408	183,704
Cemetery	23,395	22,848	73,438	75,030
Total cost of services	86,612	82,750	273,846	258,734
North America goods and services costs	198,789	183,896	617,847	595,959

International costs and expenses	2,725	3,119	8,032	123,977
Overhead and other expenses	146,012	141,504	430,087	429,234
Total costs and expenses	\$ 347,526	\$ 328,519	\$ 1,055,966	\$ 1,149,170

9. Commitments and Contingencies

Purchase Commitments

The Company entered into a purchase agreement for its North America operations with a major casket manufacturer, having an original minimum commitment of \$750,000 for a six-year period that expired at the end of 2004. The agreement contained provisions for annual price adjustments and provided for a one-year extension period to December 31, 2005 in which the Company is allowed to satisfy any remaining commitment that exists at the end of the original term. The Company elected to extend the contract to December 31, 2005 in order to satisfy its minimum commitment. In the first quarter of 2005, the Company amended its original purchase

Table of Contents

agreement. This amendment allows the Company to continue purchasing caskets through 2006 subject to price increase limitations. At September 30, 2005, the remaining commitment was \$67,700.

Management, Consulting and Non-Competition Agreements

The Company has entered into management, employment, consulting and non-competition agreements, generally for five to ten years, with certain officers and employees of the Company and former owners of businesses acquired. The Company has modified several of the above agreements as part of cost rationalization programs (see note twelve to the consolidated financial statements). At September 30, 2005, the maximum estimated future cash commitment under agreements with remaining commitment terms was as follows:

	Employment	Consulting	Non-Compete	Total
Remainder of 2005	\$ 761	\$ 615	\$ 5,254	\$ 6,630
2006	2,802	2,356	17,418	22,576
2007	1,125	2,110	11,937	15,172
2008	759	885	5,365	7,009
2009	346	804	1,960	3,110
2010 and after	168	548	4,873	5,589
Total	\$ 5,961	\$ 7,318	\$ 46,807	\$ 60,086

Litigation

The Company is a party to various litigation matters, investigations and proceedings. For each of its outstanding legal matters, the Company evaluates the merits of the case, its exposure to the matter, possible legal or settlement strategies and the likelihood of an unfavorable outcome. If the Company determines that an unfavorable outcome is probable and can be reasonably estimated, it establishes the necessary accruals. Certain insurance policies held by the Company may reduce cash outflows with respect to an adverse outcome of certain of these litigation matters. The Company accrues such insurance recoveries when they become probable of being paid and can be reasonably estimated. The following discussion describes certain litigation and proceedings as of November 9, 2005.

Conley Investment Counsel v. Service Corporation International, et al.; Civil Action 04-MD-1609; In the United States District Court for the Southern District of Texas, Houston Division (the 2003 Securities Lawsuit). The 2003 Securities Lawsuit resulted from the transfer and consolidation by the Judicial Panel on Multidistrict Litigation of three lawsuits *Edgar Neufeld v. Service Corporation International, et al.*; Cause No. CV-S-03-1561-HDM-PAL; In the United States District Court for the District of Nevada; and *Rujira Srisythemp v. Service Corporation International, et al.*; Cause No. CV-S-03-1392-LDG-LRL; In the United States District Court for the District of Nevada; and *Joshua Ackerman v. Service Corporation International, et al.*; Cause No. 04-CV-20114; In the United States District Court for the Southern District of Florida. The 2003 Securities Lawsuit names as defendants the Company and several of the Company's current and former executive officers or directors. The 2003 Securities Lawsuit is a purported class action alleging that the defendants failed to disclose the unlawful treatment of human remains and gravesites at two cemeteries in Fort Lauderdale and West Palm Beach, Florida. Since the action is in its preliminary stages, no discovery has occurred, and the Company cannot quantify its ultimate liability, if any, for the payment of damages.

David Hajar v. SCI Texas Funeral Services, Inc., SCI Funeral Services, Inc., and Service Corporation International; In the County Court of El Paso, County, Texas, County Court at Law Number Three; Cause Number 2002-740, with an interlocutory appeal pending in the El Paso Court of Appeals, No. 08-05-00182-CV, and a mandamus proceeding pending in the El Paso Court of Appeals, No. 08-05-00335-CV (collectively, the Hajar Lawsuit). The Hajar Lawsuit involves a state-wide class action brought on behalf of all persons, entities and organizations who purchased funeral services from the Company or its subsidiaries in Texas at any time since March 18, 1998. Plaintiffs allege that federal and Texas funeral related regulations and/or statutes (Rules) required the Company to disclose its markups on all items obtained from third parties in connection with funeral service contracts and that the failure to make certain disclosures of markups resulted in breach of contract and other legal claims. The Plaintiffs seek to recover an unspecified amount of monetary damages. The plaintiffs also seek attorneys' fees, costs of

court, pre- and post-judgment interest, and unspecified

Table of Contents

injunctive and declaratory relief. The Company denies that plaintiffs have standing to sue for violations of the Texas Occupations Code or the Rules, denies that any breaches of contractual terms occurred, and on other grounds denies liability on all of the plaintiffs' claims. Finally, the Company denies that the Hjar Lawsuit satisfies the requirements for class certification.

Over the course of the Hjar Lawsuit, the parties have disputed the proper scope and substance of discovery. Each side has filed various motions to compel, motions for protection and/or to quash, motions for sanctions, motions to reconsider, and/or motions to lift sanctions. The trial court has signed several discovery orders against the Company, some of which were effectively vacated when the Company sought relief from the Texas Supreme Court and when, in response to that Court's stay and request for briefing, the sole plaintiff at that time withdrew his requested discovery until summary judgment issues were decided the following year.

Each side in the Hjar Lawsuit filed motions to summarily establish that its interpretation of the Rules was correct. The Company contends that the items at issue, which plaintiffs contend were not disclosed properly under the Rules, were not cash advance items that would have been required by the Federal Trade Commission (FTC) Funeral Rule and Texas counterpart to be disclosed in a certain way on invoices. The International Cemetery and Funeral Association, the Texas Funeral Directors Association, the National Funeral Directors Association, the National Funeral Directors and Morticians Association, Inc., the Texas Funeral Service Commission, and three industry competitors filed Amicus Curiae briefs during the course of the Hjar Lawsuit, asserting that their interpretation of the Rules was the same as the Company's. Additionally, the FTC provided the Company with an informal staff opinion supporting the Company's interpretation, which the Company provided to the trial court. Despite these authorities, the trial court granted and refused to reconsider its ruling on Hjar's summary judgment motion, which summarily determined certain elements of liability based on a finding that the items at issue were cash advance items. This ruling allowed the plaintiffs to proceed to a certification hearing.

The trial court entered an order certifying the class and two subclasses on April 15, 2005. On April 29, 2005, the trial court entered an order imposing sanctions against the Company and (i) finding that the Company breached its contracts by failing to disclose that funeral goods and services were purchased from third parties and resold to customers at higher prices, and by failing to disclose the amount of price mark-ups, and (ii) approving a damage calculation methodology proposed by the plaintiffs under which the damages would equal the difference between the costs to the Company of items of funeral goods and services purchased from third parties and the price at which they were resold to persons arranging funerals, minus any legally proper off-sets. On April 29, 2005, pursuant to section 51.014(a)(3) of the Texas Civil Practice and Remedies Code, the Company filed a notice of appeal regarding the trial court's order certifying a class, and it appears from section 51.014(b) that this interlocutory appeal also stays all other proceedings in the trial court pending resolution of that appeal. The Company filed its appellants' brief of the case with the El Paso Court of Appeals in October 2005.

Concurrently with the filing of the Company's appellate brief, the Company filed a petition for writ of mandamus in a separate original proceeding. The petition seeks mandamus relief from the trial court's January and April 2005 sanction orders. The Company contends that the sanctions imposed by the trial court do not satisfy the applicable standards set forth under Texas case law, purport to change Texas law, misinterpret and misapply federal and Texas law, and were imposed on (among others) a non-party and a party to whom no discovery was ever sent. In addition, the Company contends that the April 2005 sanctions order constitutes an abuse of discretion because it was entered after the plaintiffs withdrew their request for additional discovery sanctions and during a stay on all proceedings under Texas Civil Practice and Remedies Code section 51.014(b). The Company moved to consolidate the record in the appeal and the mandamus, and to consolidate the appeal and the mandamus for hearing and decision. In October 2005, the El Paso Court of Appeals granted the motion in part, consolidating the record. The court of appeals also requested a response to the petition, with a due date of November 26, 2005. The court of appeals stated that it will consider the remainder of the consolidation request after the response is filed.

On July 7, 2005, after the trial court entered its April 2005 certification and sanction orders, the FTC issued a letter advisory opinion regarding the lawful construction of the term "cash advance item" as used in the federal Funeral Rule. This opinion had been requested by a Texas legislator who had asked whether a Texas trial court is correct in ruling that all goods or services purchased from a third-party vendor, even though not included on the contract, are cash

advances under the Funeral Rule. The FTC expressly identified this Texas trial court as the trial court in the Hijar Lawsuit and specifically referenced the trial court's summary judgment

Table of Contents

ruling. As stated in the letter, The Commission believes that the court is incorrect in ruling that *all* goods or services purchased from a third-party vendor are cash advance items. This interpretation sweeps far too broadly, potentially bringing within its scope every component good or service that comprise a funeral. This was not and is not the Commission's intention in the cash advance provisions of the Rule. In our opinion, the term cash advance item in the Rule applies only to those items that the funeral provider represents expressly to be cash advance items or represents by implication to be procured on behalf of a particular customer and provided to that customer at the same price the funeral provider paid for them. The FTC set forth its analysis in the remainder of the letter. The Company has referenced the FTC letter opinion, among other authorities, in its briefing in the court of appeals.

Mary Louise Baudino, et al v. Service Corporation International, et al; the plaintiffs' counsel in the Hajar Lawsuit initiated an arbitration claim raising similar issues in California and filed in November 2004 a case styled *Mary Louise Baudino, et al v. Service Corporation International, et al*; in Los Angeles County Superior Court; Case No. BC324007 (Baudino Lawsuit). The Baudino Lawsuit makes claims similar to those made in the Hajar lawsuit. However, the Baudino Lawsuit seeks a nation-wide class of plaintiffs.

The Company has learned that a group of parties, including three represented by plaintiffs' counsel in the Hajar Lawsuit and the Baudino Lawsuit, filed an original proceeding in the U.S. Circuit Court of Appeals challenging the July 7, 2005 FTC letter advisory opinion. The court in the Baudino Lawsuit has stayed the case pending the outcome of such challenge to the FTC letter advisory opinion. The Baudino Lawsuit is in its early stages and no discovery has been conducted.

Funeral and Casket Antitrust Litigation: As previously reported, the Company is a defendant in Cause No 4:05-CV-03394; *In re: Funeral Consumers Antitrust Litigation*; In the United States District Court for the Southern District of Texas - Houston (Funeral Consumers Case). This is a purported class action on behalf of casket consumers throughout the United States. The plaintiffs allege that the Company and several other companies involved in the funeral industry violated federal antitrust laws and state consumer laws by engaging in various anti-competitive conduct associated with the sale of caskets.

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

Another class action lawsuit that makes the same allegations as the Funeral Consumers Case has been filed against the Company in the United States District Court for the Northern District of California-San Francisco Division. It is styled Cause No. C-05-3855; *Ralph Lee Fancher v. Service Corporation International, et al.* This lawsuit has been filed on behalf of all Tennessee consumers who purchased caskets from Batesville Casket Company, The York Group, Inc. and Aurora Casket Company. The parties have agreed to transfer this case to the United States District Court for the Southern District of Texas.

Another class action lawsuit that makes the same allegations as the Funeral Consumers Case has been filed against the Company in Cameron County, Texas. It is styled Cause No. 2005-CCL-1023-C; *Leoncio Solis v. Service Corporation International*; In the County Court at Law No. 3 of Cameron County, Texas. This lawsuit has been filed on behalf of all consumers located in the state of Texas who purchased Batesville Casket Company, Inc. caskets from SCI and all consumers who are threatened with injury by the alleged conspiracies. SCI has removed this case to federal court.

The funeral and casket antitrust lawsuits seek injunctions, unspecified amounts of monetary damages and treble damages. Since the litigation is in its preliminary stages, the Company cannot quantify its ultimate liability, if any, for the payment of damages.

In addition to the funeral and casket antitrust lawsuits, the Company has received a Civil Investigative Demand, dated August 4, 2005, from the Attorney General of Maryland on behalf of itself and other state attorneys general, who have commenced an investigation of alleged anticompetitive practices in the funeral industry. The Company has also received similar Civil Investigative Demands from the Attorneys General of Florida and Connecticut.

The ultimate outcome of the litigation matters described above cannot be determined at this time. An adverse decision in one or more of such matters could have a material adverse effect on the Company, its financial condition, results of operation and cash flows. However, the Company intends to aggressively defend the lawsuits.

Table of Contents**10. Earnings per Share**

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

A reconciliation of the numerators and denominators of the basic and diluted (loss) earnings per share computations is presented below:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2005	2004	2005	2004
	(Restated)	(Restated)	(Restated)	(Restated)
	note 2	note 2	note 2	note 2
(Loss) income from continuing operations before cumulative effects of accounting changes (numerator):				
(Loss) income from continuing operations before cumulative effects of accounting changes basic	\$ (9,189)	\$ 12,865	\$ 33,003	\$ 99,288
After tax interest on convertible debt				6,419
(Loss) income from continuing operations before cumulative effects of accounting changes diluted	\$ (9,189)	\$ 12,865	\$ 33,003	\$ 105,707
Net (loss) income (numerator):				
Net (loss) income basic	\$ (9,652)	\$ 13,715	\$ (150,710)	\$ 83,666
After tax interest on convertible debt				6,419
Net (loss) income diluted	\$ (9,652)	\$ 13,715	\$ (150,710)	\$ 90,085
Shares (denominator):				
Shares basic	297,421	336,590	304,366	315,656
Stock options		3,588	4,341	4,143
Restricted stock		37	100	48
Convertible debt				29,047
Shares diluted	297,421	340,215	308,807	348,894
(Loss) income from continuing operations per share before cumulative effects of accounting changes:				
Basic	\$ (.03)	\$.04	\$.11	\$.32
Diluted	\$ (.03)	\$.04	\$.11	\$.30
Income from discontinued operations per share, net of tax:				
Basic	\$	\$	\$.01	\$.11
Diluted	\$	\$	\$.01	\$.10

Cumulative effects of accounting changes per share, net of tax:

Basic	\$		\$		\$	(.62)	\$	(.16)
Diluted	\$		\$		\$	(.61)	\$	(.14)

Net (loss) income per share:

Basic	\$	(.03)	\$	.04	\$	(.50)	\$	.27
Diluted	\$	(.03)	\$	.04	\$	(.49)	\$	.26

Table of Contents

The computation of diluted (loss) earnings per share excludes outstanding stock options and convertible debt in certain periods in which the inclusion of such items would be antidilutive in the periods presented. Total options and convertible debt not currently included in the computation of dilutive (loss) earnings per share for the respective periods are as follows:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2005	2004	2005	2004
Antidilutive options	12,091	13,436	7,052	10,204
Antidilutive convertible debt	942	1,012	967	859
Total common stock equivalents excluded from computation	13,033	14,448	8,019	11,063

11. Stockholders Equity

25

Table of Contents

Accumulated Other Comprehensive (Loss) Income

The components of *Accumulated other comprehensive (loss) income* are as follows:

Foreign currency translation	Minimum pension liability	Unrealized gains and	Accumulated other
---	--	-------------------------------------	------------------------------