

SERVICE CORPORATION INTERNATIONAL
Form 10-Q
October 25, 2012
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

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 number)

1929 Allen Parkway, Houston, Texas
(Address of principal executive offices)

77019
(Zip code)

713-522-5141

(Registrant's telephone number, including area code)

None

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting
company

(Do not check if smaller reporting
company)

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 October 23, 2012 was 212,707,060 (net of treasury shares).

Table of Contents

SERVICE CORPORATION INTERNATIONAL
INDEX

	Page
<u>Glossary</u>	<u>3</u>
<u>Part I. Financial Information</u>	<u>4</u>
<u>Item 1. Financial Statements</u>	<u>4</u>
<u>Unaudited Condensed Consolidated Statement of Operations — Three and Nine Months Ended September 30, 2012 and 2011</u>	<u>4</u>
<u>Unaudited Condensed Consolidated Statement of Comprehensive Income — Three and Nine Months Ended September 30, 2012 and 2011</u>	<u>4</u>
<u>Unaudited Condensed Consolidated Balance Sheet — September 30, 2012 and December 31, 2011</u>	<u>4</u>
<u>Unaudited Condensed Consolidated Statement of Cash Flows — Nine Months Ended September 30, 2012 and 2011</u>	<u>5</u>
<u>Unaudited Condensed Consolidated Statement of Equity — Nine Months Ended September 30, 2012 and 2011</u>	<u>5</u>
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	<u>6</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>16</u>
<u>The Company</u>	<u>16</u>
<u>Financial Condition, Liquidity, and Capital Resources</u>	<u>17</u>
<u>Results of Operations - Three and Nine Months Ended September 30, 2012 and 2011</u>	<u>23</u>
<u>Critical Accounting Policies</u>	<u>27</u>
<u>Cautionary Statement on Forward-Looking Statements</u>	<u>27</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>28</u>
<u>Item 4. Controls and Procedures</u>	<u>28</u>
<u>Part II. Other Information</u>	<u>28</u>
<u>Item 1. Legal Proceedings</u>	<u>28</u>
<u>Item 1A. Risk Factors</u>	<u>29</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>29</u>
<u>Item 6. Exhibits</u>	<u>29</u>
<u>Signature</u>	<u>31</u>

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 a death has occurred.

Burial Vaults — A reinforced container intended to inhibit the subsidence of the earth and house the casket after it is placed in the ground.

Cemetery Perpetual Care or Endowment Care Fund — A trust fund established for the purpose of maintaining cemetery grounds and property into perpetuity.

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

General Agency (GA) Revenues — Commissions we receive from third-party life insurance companies 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.

Interment — The burial or final placement of human remains in the ground, in mausoleums, or in cremation niches.

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

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

Maturity — When the underlying contracted service is performed or merchandise is delivered, typically at death. This is the point at which preneed contracts are converted to atneed contracts (note — delivery of certain merchandise and services can occur prior to death).

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

Preneed — Purchase of products and services prior to a death occurring.

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

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

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

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands, except per share amounts)			
Revenues	\$581,182	\$572,999	\$1,781,060	\$1,729,472
Costs and expenses	(459,911)	(465,949)	(1,404,033)	(1,380,953)
Gross profits	121,271	107,050	377,027	348,519
General and administrative expenses	(26,410)	(23,863)	(81,927)	(77,381)
Gains (losses) on divestitures and impairment charges, net	315	(5,001)	883	(15,264)
Operating income	95,176	78,186	295,983	255,874
Interest expense	(33,568)	(33,038)	(101,050)	(100,476)
Losses on early extinguishment of debt, net	—	(1,355)	—	(3,504)
Other income, net	2,317	249	4,001	969
Income before income taxes	63,925	44,042	198,934	152,863
Provision for income taxes	(22,128)	(9,027)	(71,183)	(51,181)
Net income	41,797	35,015	127,751	101,682
Net (income) loss attributable to noncontrolling interests	(735)	481	(1,588)	(1,329)
Net income attributable to common stockholders	\$41,062	\$35,496	\$126,163	\$100,353
Basic earnings per share:				
Net income attributable to common stockholders	\$0.19	\$0.15	\$0.58	\$0.42
Basic weighted average number of shares	214,914	232,917	216,974	237,037
Diluted earnings per share:				
Net income attributable to common stockholders	\$0.19	\$0.15	\$0.57	\$0.42
Diluted weighted average number of shares	218,460	235,513	220,306	239,528
Dividends declared per share	\$0.06	\$0.05	\$0.17	\$0.15

(See notes to unaudited condensed consolidated financial statements)

SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Net income	\$41,797	\$35,015	\$127,751	\$101,682
Other comprehensive income:				
Foreign currency translation adjustments	13,513	(23,149)	10,991	(13,229)
Total comprehensive income	55,310	11,866	138,742	88,453
Total comprehensive (income) loss attributable to noncontrolling interests	(745)	498	(1,600)	(1,316)

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

Total comprehensive income attributable to common stockholders	\$54,565	\$12,364	\$137,142	\$87,137
--	----------	----------	-----------	----------

(See notes to unaudited condensed consolidated financial statements)

SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED BALANCE SHEET
(UNAUDITED)

	September 30, 2012	December 31, 2011
	(In thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$151,547	\$128,569
Receivables, net	92,811	103,892
Deferred tax assets	38,222	44,316
Inventories, net	25,132	25,513
Other	25,777	25,803
Total current assets	333,489	328,093
Preneed funeral receivables, net and trust investments	1,527,633	1,478,865
Preneed cemetery receivables, net and trust investments	1,777,598	1,595,940
Cemetery property, at cost	1,490,930	1,497,703
Property and equipment, net	1,632,676	1,618,361
Goodwill	1,366,075	1,361,493
Deferred charges and other assets	414,410	430,851
Cemetery perpetual care trust investments	1,091,083	1,016,506
Total assets	\$9,633,894	\$9,327,812
LIABILITIES & EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$366,883	\$358,904
Current maturities of long-term debt	31,289	23,554
Income taxes	6,522	3,150
Total current liabilities	404,694	385,608
Long-term debt	1,882,834	1,861,116
Deferred preneed funeral revenues	545,987	575,546
Deferred preneed cemetery revenues	868,085	833,303
Deferred tax liability	449,228	405,615
Other liabilities	405,638	414,773
Deferred preneed funeral and cemetery receipts held in trust	2,590,639	2,424,356
Care trusts' corpus	1,090,934	1,015,300
Commitments and contingencies (Note 15)		
Equity:		
Common stock, \$1 per share par value, 500,000,000 shares authorized, 228,083,679 and 224,665,395 shares issued, respectively, and 213,973,997 and 213,974 222,956 shares outstanding, respectively		
Capital in excess of par value	1,337,014	1,430,330
Accumulated deficit	(293,260	) (367,044
Accumulated other comprehensive income	116,831	105,852
Total common stockholders' equity	1,374,559	1,392,094

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

Noncontrolling interests	21,296	20,101
Total equity	1,395,855	1,412,195
Total liabilities and equity	\$9,633,894	\$9,327,812

(See notes to unaudited condensed consolidated financial statements)

Table of Contents

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

	Nine Months Ended September 30,	
	2012	2011
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 127,751	\$ 101,682
Adjustments to reconcile net income to net cash provided by operating activities:		
Losses on early extinguishment of debt, net	—	3,504
Depreciation and amortization	89,349	88,363
Amortization of intangible assets	17,950	19,497
Amortization of cemetery property	31,528	27,889
Amortization of loan costs	3,635	3,259
Provision for doubtful accounts	6,801	6,431
Provision for deferred income taxes	57,428	40,038
(Gains) losses on divestitures and impairment charges, net	(883	) 15,264
Share-based compensation	8,217	6,843
Change in assets and liabilities, net of effects from acquisitions and divestitures:		
Decrease in receivables	4,857	13,583
(Increase) decrease in other assets	(6,331	) 2,560
Increase in payables and other liabilities	6,623	7,808
Effect of preneed funeral production and maturities:		
Decrease in preneed funeral receivables, net and trust investments	30,343	47,263
Decrease in deferred preneed funeral revenue	(30,325	) (30,724
Decrease in deferred preneed funeral receipts held in trust	(18,185	) (33,203
Effect of cemetery production and deliveries:		
Increase in preneed cemetery receivables, net and trust investments	(72,012	) (47,977
Increase in deferred preneed cemetery revenue	27,502	26,502
Decrease in deferred preneed cemetery receipts held in trust	(480	) (6,280
Other	(3,481	) (989
Net cash provided by operating activities	280,287	291,313
Cash flows from investing activities:		
Capital expenditures	(80,973	) (85,936
Acquisitions	(19,281	) (97,473
Proceeds from divestitures and sales of property and equipment, net	8,933	15,233
Other	(3,816	) 956
Net cash used in investing activities	(95,137	) (167,220
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	17,907	65,000
Payments of debt	(988	) (2,169
Early extinguishment of debt	—	(43,089
Principal payments on capital leases	(19,303	) (17,186
Proceeds from exercise of stock options	17,347	7,694
Purchase of Company common stock	(144,607	) (146,590
Payments of dividends	(34,844	) (33,395
Bank overdrafts and other	868	3,573

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

Net cash used in financing activities	(163,620	)	(166,162)
Effect of foreign currency on cash and cash equivalents	1,448		(1,740)
Net increase (decrease) in cash and cash equivalents	22,978		(43,809)
Cash and cash equivalents at beginning of period	128,569		170,846	
Cash and cash equivalents at end of period	\$151,547		\$127,037	

(See notes to unaudited condensed consolidated financial statements)

SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED STATEMENT OF EQUITY

(UNAUDITED)

(In thousands)

	Common Stock	Treasury Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total
Balance at December 31, 2010	\$242,020	\$(985)	\$1,603,112	\$(477,459)	\$112,768	\$492	\$1,479,948
Comprehensive income	—	—	—	100,353	(13,216)	1,316	88,453
Dividends declared on common stock (\$.15 per share)	—	—	(35,140)	—	—	—	(35,140)
Employee share-based compensation earned	—	—	6,843	—	—	—	6,843
Stock option exercises	1,137	—	6,557	—	—	—	7,694
Restricted stock awards, net of forfeitures	539	—	(539)	—	—	—	—
Purchase of Company common stock	—	(14,785)	(109,914)	(21,891)	—	—	(146,590)
Acquisition	—	—	—	—	—	18,857	18,857
Noncontrolling interest payment	—	—	—	—	—	(568)	(568)
Other	72	—	680	—	—	—	752
Balance at September 30, 2011	\$243,768	\$(15,770)	\$1,471,599	\$(398,997)	\$99,552	\$20,097	\$1,420,249
Balance at December 31, 2011	224,666	(1,710)	1,430,330	(367,044)	105,852	20,101	1,412,195
Comprehensive income	—	—	—	126,163	10,979	1,600	138,742
Dividends declared on common stock (\$.17 per share)	—	—	(36,582)	—	—	—	(36,582)
Employee share-based compensation earned	—	—	8,217	—	—	—	8,217
Stock option exercises	2,853	—	14,494	—	—	—	17,347
Restricted stock awards, net of forfeitures	483	—	(483)	—	—	—	—
Purchase of Company common stock	—	(12,400)	(79,828)	(52,379)	—	—	(144,607)

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

Noncontrolling interest payment	—	—	—	—	—	(405)	(405)
Other	82		866	—	—	—	948
Balance at September 30, 2012	\$228,084	\$(14,110)	\$1,337,014	\$(293,260)	\$116,831	\$21,296	\$1,395,855

(See notes to unaudited condensed consolidated financial statements)

Table of Contents

SERVICE CORPORATION INTERNATIONAL

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share amounts)

1. Nature of Operations

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

2. Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

Our unaudited condensed consolidated financial statements include the accounts of Service Corporation International (SCI) and all subsidiaries in which we hold a controlling financial interest. Our financial statements also include the accounts of the funeral merchandise and service trusts, cemetery merchandise and service trusts and cemetery perpetual care trusts in which we have a variable interest and are the primary beneficiary. Our interim condensed consolidated financial statements are unaudited but include all adjustments, consisting of normal recurring accruals and any other adjustments, which management considers necessary for a fair statement of our results for these periods. Our unaudited condensed consolidated financial statements have been prepared in a manner consistent with the accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2011, unless otherwise disclosed herein, and should be read in conjunction therewith. The accompanying year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year period.

Use of Estimates in the Preparation of Financial Statements

The preparation of the unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions as described in our Annual Report on Form 10-K for the year ended December 31, 2011. These estimates and assumptions may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. As a result, actual results could differ from these estimates.

Preneed Funeral and Cemetery Receivables

We sell preneed funeral and cemetery contracts whereby the customer enters into arrangements for future merchandise and services prior to the time of need. As these contracts are prior to the delivery of the related goods and services, the preneed funeral and cemetery receivables are offset by a comparable deferred revenue amount. These receivables generally have an interest component for which interest income is recorded when the interest amount is considered collectible and realizable, which typically coincides with cash payment. We do not accrue interest on financing receivables that are not paid in accordance with the contractual payment date given the nature of our goods and services, the nature of our contracts with customers, and the timing of the delivery of our services. We do not consider receivables to be past due until the service or goods are required to be delivered at which time the preneed receivable is paid or reclassified as a trade receivable with payment terms of less than 30 days. As the preneed funeral and cemetery receivables are offset by comparable deferred revenue amounts, we have no risk of loss related to these receivables.

If a preneed contract is canceled 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 the 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 the consolidated statement of operations. In certain jurisdictions, we may be obligated to fund any shortfall if the amount deposited by the customers exceed the funds in trust. Based on our historical experience, we have provided an allowance for cancellation of these receivables, which is recorded as a reduction in receivables with a corresponding offset to deferred revenue.

Fair Value Measurements

In May 2011, the Financial Accounting Standards Board (FASB) amended the Fair Value Measurements and Disclosure (FVM&D) Topic of the Accounting Standards Codification (ASC) to expand disclosures about items marked to fair value that are categorized within Level 3 of the fair value hierarchy to include qualitative explanations of the valuation methodology used, sensitivity analysis of the inputs into the valuation, and quantitative information about those inputs. The amendment also requires that items that are not measured at fair value but for which the fair value is disclosed also disclose the level in the fair value hierarchy in which those items were categorized. We adopted the amended guidance in the first quarter of 2012 and the appropriate disclosures are contained in Notes 4, 5, and 6. Comprehensive Income

In June 2011, the FASB amended the Comprehensive Income Topic of the ASC to require the disclosure of the components of other comprehensive income, which we previously disclosed elsewhere in our filings, be shown as either part of one statement of comprehensive income or as a separate statement of comprehensive income immediately following the income statement. We adopted the amended guidance in the first quarter of 2012 and a separate Statement of Comprehensive Income is included herein.

3. Recently Issued Accounting Standards

Intangible Testing

In July 2012, the FASB amended the Intangibles - Goodwill and Other Topic of the ASC that allows us to make a qualitative assessment of whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount. If, after assessing the relevant information, we determine it is more likely than not that the fair value is more than the carrying amount, no additional analysis is necessary. If we determine it is more likely than not that the fair value is less than the carrying amount, then we are required to proceed to the quantitative approach. The amended guidance is effective for us in our annual test in the fourth quarter of 2013, and adoption is not expected to impact our consolidated financial condition or results of operations.

Goodwill Testing

In September 2011, the FASB amended the Intangibles - Goodwill and Other Topic of the ASC that allows us to make a qualitative assessment of whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. If, after assessing the relevant information, we determine it is more likely than not that the fair value is more than the carrying amount, no additional analysis is necessary. If we determine it is more likely than not that the fair value is less than the carrying amount, then we are required to proceed to the quantitative approach. The amended guidance is effective for us in our annual test in the fourth quarter of 2012, and adoption is not expected to impact our consolidated financial condition or results of operations.

4. Preneed Funeral Activities

Preneed funeral receivables, net and trust investments represent trust investments, including investment earnings, and customer receivables, net of unearned finance charges, related to unperformed, price-guaranteed preneed funeral contracts. Our funeral merchandise and service trusts are variable interest entities as defined in the Consolidation Topic of the ASC. In accordance with this guidance, we have determined that we are the primary beneficiary of these trusts, as we absorb a majority of the losses and returns associated with these trusts. Our cemetery trust investments detailed in Notes 5 and 6 are also accounted for as variable interest entities. When we receive payments from the customer, we deposit the amount required by law into the trust and reclassify the corresponding amount from Deferred preneed funeral revenues into Deferred preneed funeral and cemetery receipts held in trust. Amounts are withdrawn from the trusts after the contract obligations are performed. Cash flows from preneed funeral contracts are presented

as operating cash flows in our unaudited condensed consolidated statement of cash flows.

Preneed funeral receivables, net and trust investments are reduced by the trust investment earnings (realized and unrealized) that we have been allowed to withdraw in certain states prior to maturity. These earnings are recorded in Deferred preneed funeral revenues until the service is performed or the merchandise is delivered.

The table below sets forth certain investment-related activities associated with our preneed funeral merchandise and service trusts:

6

Table of Contents

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Deposits	\$19,982	\$18,960	\$64,081	\$55,189
Withdrawals	22,943	26,789	78,034	79,734
Purchases of available-for-sale securities	53,034	140,554	324,304	387,545
Sales of available-for-sale securities	51,672	114,476	323,471	448,988
Realized gains from sales of available-for-sale securities	7,681	11,353	43,446	49,618
Realized losses from sales of available-for-sale securities	(4,570)	(6,586)	(18,730)	(18,215)

The components of Preneed funeral receivables, net and trust investments in our unaudited condensed consolidated balance sheet at September 30, 2012 and December 31, 2011 are as follows:

	September 30,	December 31,
	2012	2011
	(In thousands)	
Trust investments, at fair value	\$968,394	\$892,685
Cash and cash equivalents	87,519	101,111
Insurance-backed fixed income securities	272,677	277,650
Trust investments	1,328,590	1,271,446
Receivables from customers	241,377	246,601
Unearned finance charge	(8,557)	(5,425)
	1,561,410	1,512,622
Allowance for cancellation	(33,777)	(33,757)
Preneed funeral receivables, net and trust investments	\$1,527,633	\$1,478,865

The cost and fair values associated with our funeral merchandise and service trust investments recorded at fair value at September 30, 2012 and December 31, 2011 are detailed below. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds, and private equity investments. Fair value represents the market value of the underlying securities held by the common trust funds, mutual funds at published values, and the estimated fair value of private equity investments (including debt as well as the estimated fair value related to the contract holder's equity in majority-owned real estate investments).

Table of Contents

	September 30, 2012				
	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Value
			(In thousands)		
Fixed income securities:					
U.S. Treasury	2	\$ 104,430	\$ 5,093	\$(921)	\$ 108,602
Canadian government	2	113,880	717	(84)	114,513
Corporate	2	52,424	2,302	(574)	54,152
Residential mortgage-backed	2	3,296	76	(4)	3,368
Asset-backed	2	127	3	—	130
Equity securities:					
Preferred stock	2	2,897	184	(135)	2,946
Common stock:					
United States	1	220,152	47,415	(8,259)	259,308
Canada	1	23,081	2,036	(1,516)	23,601
Other international	1	17,384	2,094	(574)	18,904
Mutual funds:					
Equity	1	147,131	6,464	(8,755)	144,840
Fixed income	1	221,433	8,322	(8,908)	220,847
Private equity	3	37,346	211	(21,288)	16,269
Other	3	536	378	—	914
Trust investments		\$944,117	\$75,295	\$(51,018)	\$968,394

	December 31, 2011				
	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Value
			(In thousands)		
Fixed income securities:					
U.S. Treasury	2	\$ 77,299	\$ 4,565	\$(373)	\$ 81,491
Canadian government	2	114,586	838	(109)	115,315
Corporate	2	49,210	1,849	(770)	50,289
Residential mortgage-backed	2	3,292	71	(34)	3,329
Asset-backed	2	126	6	—	132
Equity securities:					
Preferred stock	2	2,041	50	(153)	1,938
Common stock:					
United States	1	258,738	40,992	(22,715)	277,015
Canada	1	23,986	2,511	(1,771)	24,726
Other international	1	18,954	1,045	(1,296)	18,703
Mutual funds:					
Equity	1	134,383	2,384	(18,982)	117,785
Fixed income	1	193,134	5,044	(13,114)	185,064
Private equity	3	35,017	218	(19,249)	15,986
Other	3	484	428	—	912
Trust investments		\$911,250	\$60,001	\$(78,566)	\$892,685

Where quoted prices are available in an active market, securities held by the common trust funds and mutual funds are classified as Level 1 investments pursuant to the three-level valuation hierarchy as required by the FVM&D Topic of

the ASC.

8

Table of Contents

Where quoted market prices are not available for the specific security, fair values are estimated by using either quoted prices of securities with similar characteristics or an income approach fair value model with observable inputs that include a combination of interest rates, yield curves, credit risks, prepayment speeds, rating, and tax-exempt status. These funds are classified as Level 2 investments pursuant to the three-level valuation hierarchy as required by the FVM&D Topic of the ASC.

The valuation of private equity and other alternative investments requires management judgment due to the absence of quoted market prices, inherent lack of liquidity, and the long-term nature of such assets. The fair value of these investments is estimated based on the market value of the underlying real estate and private equity investments. The underlying real estate value is determined using the most recent available appraisals. As of September 30, 2012, private equity instruments are valued based on reported net asset values discounted by 0% to 60% for risk and 0% to 25% for liquidity. A significant increase (decrease) in the discounts results in a directionally opposite change in the fair value of the instruments. Valuation policies and procedures are determined by our Treasury department, which reports to our Chief Financial Officer. Additionally, valuations are reviewed by our investment committee quarterly. These funds are classified as Level 3 investments pursuant to the three-level valuation hierarchy as required by the FVM&D Topic of the ASC.

As of September 30, 2012, our unfunded commitment for our private equity and other investments was \$12.3 million which, if called, would be funded by the assets of the trusts. Our private equity and other investments include several funds that invest in limited partnerships, distressed debt, real estate, and mezzanine financing. These investments can never be redeemed by the funds. Instead, the nature of the investments in this category is that the distributions are received through the liquidation of the underlying assets of the funds. We estimate that the underlying assets will be liquidated over the next 2 to 10 years.

The change in our market-based funeral merchandise and service trust investments with significant unobservable inputs (Level 3) is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Fair value, beginning balance	\$17,268	\$29,031	\$16,898	\$21,359
Net unrealized losses included in Accumulated other comprehensive income(1)	(748)	(7,757)	(2,332)	(1,001)
Net realized losses included in Other income, net(2)	(12)	(8)	(28)	(67)
Purchases	—	18	—	18
Sales	—	(7,970)	(9)	(8,156)
Contributions	995	7,615	3,554	9,397
Distributions and other	(320)	(522)	(900)	(1,143)
Fair value, ending balance	\$17,183	\$20,407	\$17,183	\$20,407

All unrealized losses recognized in Accumulated other comprehensive income for our funeral merchandise and service trust investments are attributable to our preneed customers and are offset by a corresponding (1) reclassification in Accumulated other comprehensive income to Deferred preneed funeral and cemetery receipts held in trust. See Note 7 for further information related to our Deferred preneed funeral and cemetery receipts held in trust.

(2) All losses recognized in Other income, net for our funeral merchandise and service trust investments are attributable to our preneed customers and are offset by a corresponding reclassification in Other income, net to Deferred preneed funeral and cemetery receipts held in trust. See Note 7 for further information related to our Deferred preneed funeral and cemetery receipts held in trust.

Maturity dates of our fixed income securities range from 2012 to 2053. Maturities of fixed income securities, excluding mutual funds, at September 30, 2012 are estimated as follows:

Fair Value
(In thousands)

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

Due in one year or less	\$132,075
Due in one to five years	60,638
Due in five to ten years	52,893
Thereafter	35,159
	\$280,765

Earnings from all our funeral merchandise and service trust investments are recognized in funeral revenues when a service

9

Table of Contents

is performed or merchandise is delivered. Fees charged by our wholly-owned registered investment advisor are also included in current revenues in the period in which they are earned. In addition, we are entitled to retain, in certain jurisdictions, a portion of collected customer payments when a customer cancels a preneed contract; these amounts are also recognized in current revenues. Recognized earnings (realized and unrealized) related to these trust investments were \$8.5 million and \$10.2 million for the three months ended September 30, 2012 and 2011, respectively.

Recognized earnings (realized and unrealized) related to these trust investments were \$27.7 million and \$28.9 million for the nine months ended September 30, 2012 and 2011, respectively.

We assess our trust investments for other-than-temporary declines in fair value on a quarterly basis. Impairment charges resulting from this assessment are recognized as investment losses in Other income, net and a decrease to Preneed funeral receivables, net and trust investments. These investment losses, if any, are offset by the corresponding reclassification in Other income, net, which reduces Deferred preneed funeral receipts held in trust. See Note 7 for further information related to our Deferred preneed funeral receipts held in trust. For the three months ended September 30, 2012 and 2011, we recorded a \$0.2 million and a \$17.5 million impairment charge for other-than-temporary declines in fair value related to unrealized losses on certain investments, respectively. For the nine months ended September 30, 2012 and 2011, we recorded a \$0.7 million and a \$20.8 million impairment charge for other-than-temporary declines in fair value related to unrealized losses on certain investments.

We have determined that the remaining unrealized losses in our funeral merchandise and service trust investments are considered temporary in nature, as the unrealized losses were due to temporary fluctuations in interest rates and equity prices. The investments are diversified across multiple industry segments using a balanced allocation strategy to minimize long-term risk. We believe that none of the securities are other-than-temporarily impaired based on our analysis of the investments. Our analysis included a review of the portfolio holdings and discussions with the individual money managers as to the sector exposures, credit ratings and the severity and duration of the unrealized losses. Our funeral merchandise and service trust investment unrealized losses, their associated fair values, and the duration of unrealized losses as of September 30, 2012 and December 31, 2011, respectively, are shown in the following tables:

	September 30, 2012		September 30, 2011		Total	
	In Loss Position Less Than 12 Months		In Loss Position Greater Than 12 Months		Fair Value	Unrealized Losses
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Fixed income securities:						
U.S. Treasury	\$23,489	\$(844)	\$6,279	\$(77)	\$29,768	\$(921)
Canadian government	8,475	(84)	—	—	8,475	(84)
Corporate	11,083	(403)	3,093	(171)	14,176	(574)
Residential mortgage-backed	712	(4)	—	—	712	(4)
Equity securities:						
Preferred stock	824	(55)	233	(80)	1,057	(135)
Common stock:						
United States	47,144	(4,921)	10,298	(3,338)	57,442	(8,259)
Canada	6,431	(877)	2,385	(639)	8,816	(1,516)
Other international	3,855	(253)	1,555	(321)	5,410	(574)
Mutual funds:						
Equity	31,439	(406)	32,304	(8,349)	63,743	(8,755)
Fixed income	47,052	(1,011)	13,760	(7,897)	60,812	(8,908)
Private equity	614	(1,790)	15,294	(19,498)	15,908	(21,288)
Total temporarily impaired securities	\$181,118	\$(10,648)	\$85,201	\$(40,370)	\$266,319	\$(51,018)

Table of Contents

	December 31, 2011		In Loss Position		Total	
	Less Than 12 Months		Greater Than 12 Months			
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
Fixed income securities:						
U.S. Treasury	\$6,977	\$(90)	\$8,709	\$(283)	\$15,686	\$(373)
Canadian government	9,597	(109)	—	—	9,597	(109)
Corporate	17,328	(692)	662	(78)	17,990	(770)
Residential mortgage-backed	600	(4)	295	(30)	895	(34)
Equity securities:						
Preferred stock	1,244	(153)	—	—	1,244	(153)
Common stock:						
United States	84,450	(18,120)	14,924	(4,595)	99,374	(22,715)
Canada	8,448	(1,491)	513	(280)	8,961	(1,771)
Other international	7,263	(615)	2,403	(681)	9,666	(1,296)
Mutual funds:						
Equity	76,559	(9,173)	26,053	(9,809)	102,612	(18,982)
Fixed income	68,378	(5,500)	9,314	(7,614)	77,692	(13,114)
Private equity	1,977	(3,499)	13,502	(15,750)	15,479	(19,249)
Total temporarily impaired securities	\$282,821	\$(39,446)	\$76,375	\$(39,120)	\$359,196	\$(78,566)

5. Preneed Cemetery Activities

Preneed cemetery receivables, net and trust investments represent trust investments, including investment earnings, and customer receivables, net of unearned finance charges, for contracts sold in advance of when the property interment rights, merchandise, or services are needed. Our cemetery merchandise and service trusts are variable interest entities as defined in the Consolidation Topic of the ASC. In accordance with this guidance, we have determined that we are the primary beneficiary of these trusts, as we absorb a majority of the losses and returns associated with these trusts. The trust investments detailed in Notes 4 and 6 are also accounted for as variable interest entities. When we receive payments from the customer, we deposit the amount required by law into the trust and reclassify the corresponding amount from Deferred preneed cemetery revenues into Deferred preneed funeral and cemetery receipts held in trust. Amounts are withdrawn from the trusts when the contract obligations are performed. Cash flows from preneed cemetery contracts are presented as operating cash flows in our unaudited condensed consolidated statement of cash flows.

Preneed cemetery receivables, net and trust investments are reduced by the trust investment earnings (realized and unrealized) that we have been allowed to withdraw in certain states prior to maturity. These earnings are recorded in Deferred preneed cemetery revenues until the service is performed or the merchandise is delivered.

The table below sets forth certain investment-related activities associated with our preneed cemetery merchandise and service trusts:

	Three Months Ended		Nine Months Ended	
	September 30, 2012	2011	September 30, 2012	2011
	(In thousands)			
Deposits	\$25,010	\$25,946	\$75,717	\$76,442
Withdrawals	28,260	25,917	75,623	84,444
Purchases of available-for-sale securities	114,549	88,518	443,613	411,195
Sales of available-for-sale securities	111,663	78,721	428,350	407,272

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

Realized gains from sales of available-for-sale securities	9,754	10,134	57,636	51,225
Realized losses from sales of available-for-sale securities	(6,962)	(8,758)	(25,028)	(19,994)

The components of Preened cemetery receivables, net and trust investments in our unaudited condensed consolidated balance sheet at September 30, 2012 and December 31, 2011 are as follows:

11

Table of Contents

	September 30, 2012	December 31, 2011
	(In thousands)	
Trust investments, at fair value	\$1,171,117	\$1,051,464
Cash and cash equivalents	94,446	104,554
Insurance-backed fixed income securities	4	5
Trust investments	1,265,567	1,156,023
Receivables from customers	590,448	517,917
Unearned finance charges	(30,805	) (33,766
	1,825,210	1,640,174
Allowance for cancellation	(47,612)