

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

74-1488375

(State or other jurisdiction of incorporation or  
organization)

(I. R. S. employer identification number)

1929 Allen Parkway, Houston, Texas

77019

(Address of principal executive offices)

(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)	
<b>ASSETS</b>		
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
<b>LIABILITIES &amp; EQUITY</b>		
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 213,974 222,956 222,955,853 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 September 30,		Nine Months Ended 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, 2012	December 31, 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 September 30,		Nine Months Ended 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

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					
	In Loss Position		In Loss Position		Total	
	Less Than 12 Months		Greater Than 12 Months			
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses	Value	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		In Loss Position		Total	
	Less Than 12 Months		Greater Than 12 Months			
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses	Value	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,		September 30,	
	2012	2011	2012	2011
	(In thousands)		(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:

Table of Contents

	September 30, 2012 (In thousands)	December 31, 2011
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 )	(44,234 )
Preneed cemetery receivables, net and trust investments	\$1,777,598	\$1,595,940

The cost and fair values associated with our cemetery 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.

	September 30, 2012				
	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Value
			(In thousands)		
Fixed income securities:					
U.S. Treasury	2	\$97,653	\$8,116	\$(890 )	\$104,879
Canadian government	2	17,233	412	(62 )	17,583
Corporate	2	42,906	2,383	(788 )	44,501
Residential mortgage-backed	2	162	5	—	167
Equity securities:					
Preferred stock	2	4,771	294	(286 )	4,779
Common stock:					
United States	1	349,200	90,099	(10,828 )	428,471
Canada	1	15,146	2,465	(1,093 )	16,518
Other international	1	28,750	4,036	(851 )	31,935
Mutual funds:					
Equity	1	264,373	10,128	(11,521 )	262,980
Fixed income	1	246,400	12,359	(15,904 )	242,855
Private equity	3	33,553	59	(17,604 )	16,008
Other	3	408	35	(2 )	441
Trust investments		\$1,100,555	\$130,391	\$(59,829 )	\$1,171,117

Table of Contents

	December 31, 2011				
	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Value
(In thousands)					
Fixed income securities:					
U.S. Treasury	2	\$51,022	\$6,438	\$(313)	\$57,147
Canadian government	2	16,566	381	(24)	16,923
Corporate	2	42,803	2,033	(961)	43,875
Residential mortgage-backed	2	167	5	(2)	170
Equity securities:					
Preferred stock	2	3,365	86	(270)	3,181
Common stock:					
United States	1	408,075	71,138	(30,454)	448,759
Canada	1	18,289	2,547	(1,780)	19,056
Other international	1	30,501	1,843	(1,536)	30,808
Mutual funds:					
Equity	1	197,523	3,317	(24,911)	175,929
Fixed income	1	248,529	11,670	(20,238)	239,961
Private equity	3	30,783	53	(15,617)	15,219
Other	3	306	130	—	436
Trust investments		\$1,047,929	\$99,641	\$(96,106)	\$1,051,464

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.

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 \$13.0 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 cemetery merchandise and service trust investments with significant unobservable inputs (Level 3) is as follows (in thousands):





Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Fair value, beginning balance	\$16,229	\$14,674	\$15,655	\$6,251
Net unrealized losses included in Accumulated other comprehensive income(1)	(442 )	(8,530 )	(1,919 )	(1,545 )
Net realized losses included in Other (expense) income, net(2)	(13 )	(8 )	(32 )	(73 )
Contributions	1,044	7,910	3,760	9,762
Distributions and other	(369 )	59	(1,015 )	(290 )
Fair value, ending balance	\$16,449	\$14,105	\$16,449	\$14,105

All unrealized losses recognized in Accumulated other comprehensive income for our cemetery 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 cemetery 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 2041. Maturities of fixed income securities, excluding mutual funds, at September 30, 2012 are estimated as follows:

	Fair Value (In thousands)
Due in one year or less	\$9,154
Due in one to five years	58,737
Due in five to ten years	48,308
Thereafter	50,931
	\$167,130

Earnings from all our cemetery merchandise and service trust investments are recognized in current cemetery revenues when a service 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 \$6.7 million and \$4.6 million for the three months ended September 30, 2012 and 2011, respectively. Recognized earnings (realized and unrealized) related to these trust investments were \$20.0 million and \$15.7 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 cemetery receivables, net and trust investments. These investment losses, if any, are offset by the corresponding reclassification in Other income, net, which reduces Deferred preneed cemetery receipts held in trust. See Note 7 for further information related to our Deferred preneed cemetery receipts held in trust. For the three months ended September 30, 2012 and 2011, we recorded a \$0.2 million and a \$24.9 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 \$0.8 million and a \$26.1 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 cemetery 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 cemetery merchandise and service trust investment unrealized losses, their associated fair values and the duration of unrealized losses as of September 30, 2012 are shown in the following tables:

Table of Contents

	September 30, 2012					
	In Loss Position		In Loss Position		Total	
	Less Than 12 Months		Greater Than 12 Months			
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses	Value	Losses
	(In thousands)					
Fixed income securities:						
U.S. Treasury	\$28,269	\$(890 )	\$—	\$—	\$28,269	\$(890 )
Canadian government	5,724	(62 )	—	—	5,724	(62 )
Corporate	17,118	(627 )	1,470	(161 )	18,588	(788 )
Equity securities:						
Preferred stock	872	(77 )	603	(209 )	1,475	(286 )
Common stock:						
United States	65,739	(6,698 )	14,006	(4,130 )	79,745	(10,828 )
Canada	2,791	(629 )	1,325	(464 )	4,116	(1,093 )
Other international	5,891	(395 )	2,117	(456 )	8,008	(851 )
Mutual funds:						
Equity	44,774	(882 )	42,289	(10,639 )	87,063	(11,521 )
Fixed income	43,307	(1,051 )	27,517	(14,853 )	70,824	(15,904 )
Private equity	48	(23 )	15,451	(17,581 )	15,499	(17,604 )
Other	12	(1 )	382	(1 )	394	(2 )
Total temporarily impaired securities	\$214,545	\$(11,335 )	\$105,160	\$(48,494 )	\$319,705	\$(59,829 )

	December 31, 2011					
	In Loss Position		In Loss Position		Total	
	Less Than 12 Months		Greater Than 12 Months			
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses	Value	Losses
	(In thousands)					
Fixed income securities:						
U.S. Treasury	\$1,736	\$(51 )	\$3,038	\$(262 )	\$4,774	\$(313 )
Canadian government	4,024	(24 )	—	—	4,024	(24 )
Corporate	15,044	(850 )	1,747	(111 )	16,791	(961 )
Residential mortgage-backed	2	(1 )	15	(1 )	17	(2 )
Equity securities:						
Preferred stock	1,583	(270 )	—	—	1,583	(270 )
Common stock:						
United States	123,849	(26,401 )	17,085	(4,053 )	140,934	(30,454 )
Canada	7,694	(1,260 )	366	(520 )	8,060	(1,780 )
Other international	8,654	(629 )	3,772	(907 )	12,426	(1,536 )
Mutual funds:						
Equity	115,725	(11,222 )	36,398	(13,689 )	152,123	(24,911 )
Fixed income	48,950	(7,686 )	9,367	(12,552 )	58,317	(20,238 )
Private equity	466	(254 )	14,213	(15,363 )	14,679	(15,617 )
Total temporarily impaired securities	\$327,727	\$(48,648 )	\$86,001	\$(47,458 )	\$413,728	\$(96,106 )

## 6. Cemetery Perpetual Care Trusts

We are required by state and provincial law to pay into cemetery perpetual care trusts a portion of the proceeds from the sale of cemetery property interment rights. Our cemetery perpetual care 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 merchandise and service trust investments detailed in Notes 4 and 5 are also accounted for as variable interest entities. We consolidate our cemetery perpetual care trust investments with a corresponding amount recorded as Care trusts' corpus. Cash flows from cemetery perpetual care trusts are presented as operating cash flows in our unaudited condensed consolidated statement of cash flows.

The table below sets forth certain investment-related activities associated with our cemetery perpetual care trusts:

	Three Months Ended September 30, 2012		September 30, 2011	
	(In thousands)		(In thousands)	
Deposits	\$6,501	\$5,503	\$18,866	\$17,806
Withdrawals	9,239	10,269	23,422	28,098
Purchases of available-for-sale securities	24,467	87,135	126,478	413,176
Sales of available-for-sale securities	27,733	49,705	101,110	387,715
Realized gains from sales of available-for-sale securities	3,328	4,101	7,522	31,221
Realized losses from sales of available-for-sale securities	(1,518 )	(1,764 )	(5,435 )	(14,506 )

The components of Cemetery perpetual care trust investments in our unaudited condensed consolidated balance sheet at September 30, 2012 and December 31, 2011 are as follows:

	September 30, 2012	December 31, 2011
	(In thousands)	
Trust investments, at fair value	\$1,033,292	\$952,573
Cash and cash equivalents	57,791	63,933
Cemetery perpetual care trust investments	\$1,091,083	\$1,016,506

The cost and fair values associated with our cemetery perpetual care 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 value of the underlying securities or cash held by the common trust funds, mutual funds at published values, and the estimated fair value of private equity investments.

	September 30, 2012				
	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Value
			(In thousands)		
Fixed income securities:					
U.S. Treasury	2	\$808	\$49	\$(1 )	\$856
Canadian government	2	29,977	734	(102 )	30,609
Corporate	2	19,597	548	(118 )	20,027
Residential mortgage-backed	2	1,562	51	(1 )	1,612
Asset-backed	2	161	9	—	170
Equity securities:					
Preferred stock	2	5,641	1	(828 )	4,814
Common stock:					
United States	1	158,941	23,050	(3,633 )	178,358
Canada	1	9,150	1,341	(860 )	9,631
Other international	1	16,256	1,340	(263 )	17,333
Mutual funds:					

## Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

Equity	1	18,036	2,600	(132 )	20,504
Fixed income	1	674,118	57,906	(984 )	731,040
Private equity	3	24,600	337	(14,052 )	10,885
Other	3	9,464	1,088	(3,099 )	7,453
Cemetery perpetual care trust investments		\$968,311	\$89,054	\$(24,073 )	\$1,033,292

December 31, 2011					
	Fair Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Fair Value
(In thousands)					
Fixed income securities:					
U.S. Treasury	2	\$981	\$39	\$—	\$1,020
Canadian government	2	29,015	686	(43 )	29,658
Corporate	2	21,197	528	(134 )	21,591
Residential mortgage-backed	2	1,662	53	(13 )	1,702
Asset-backed	2	83	2	(1 )	84
Equity securities:					
Preferred stock	2	6,475	18	(1,146 )	5,347
Common stock:					
United States	1	141,880	14,443	(9,113 )	147,210
Canada	1	13,374	1,483	(1,423 )	13,434
Other international	1	16,836	1,314	(1,421 )	16,729
Mutual funds:					
Equity	1	21,801	1,598	(579 )	22,820
Fixed income	1	654,883	29,758	(9,402 )	675,239
Private equity	3	23,212	374	(12,737 )	10,849
Other	3	8,018	850	(1,978 )	6,890
Cemetery perpetual care trust investments		\$939,417	\$51,146	\$(37,990 )	\$952,573

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.

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 \$6.0 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 cemetery perpetual care trust investments with significant unobservable inputs (Level 3) is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Fair value, beginning balance	\$18,923	\$19,055	\$17,739	\$17,089
Net unrealized gains (losses) included in Accumulated other comprehensive income(1)	828	(2,377 )	1,483	5,525
Net realized (losses) gains included in Other income, net(2)	(41 )	4	(129 )	(187 )
Sales	—	—	(26 )	(44 )
Contributions	465	18	3,244	115
Distributions and other	(1,837 )	856	(3,973 )	(4,942 )
Fair value, ending balance	\$18,338	\$17,556	\$18,338	\$17,556

All unrealized gains (losses) recognized in Accumulated other comprehensive income for our cemetery perpetual (1)care trust investments are offset by a corresponding reclassification in Accumulated other comprehensive income to Care trusts' corpus. See Note 7 for further information related to our Care trusts' corpus.

All (losses) gains recognized in Other income, net for our cemetery perpetual care trust investments are offset by a (2)corresponding reclassification in Other income, net to Care trusts' corpus. See Note 7 for further information related to our Care trusts' corpus.

Maturity dates of our fixed income securities range from 2012 to 2041. Maturities of fixed income securities at September 30, 2012 are estimated as follows:

	Fair Value (In thousands)
Due in one year or less	\$8,353
Due in one to five years	18,449
Due in five to ten years	25,112
Thereafter	1,360
	\$53,274

Distributable earnings from these cemetery perpetual care trust investments are recognized in current cemetery revenues to the extent we incur qualifying cemetery maintenance costs. Fees charged by our wholly-owned registered investment advisor are also included in current revenues in the period in which they are earned. Recognized earnings related to these trust investments were \$10.5 million and \$9.0 million for the three months ended September 30, 2012 and 2011, respectively. Recognized earnings related to these trust investments were \$29.6 million and \$31.0 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 Cemetery perpetual care trust investments. These investment losses, if any, are offset by the corresponding reclassification in Other income, net, which reduces Care trusts' corpus. See Note 7 for further information related to our Care trusts' corpus. For both the three months ended September 30, 2012 and 2011, we recorded a \$0.0 million impairment charge for other-than-temporary declines in fair value related to unrealized losses on certain investments. For both the nine months ended September 30, 2012 and 2011, we recorded a \$0.3 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 cemetery perpetual care 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

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

individual money managers as to the sector exposures, credit ratings, and the severity and duration of the unrealized losses. Our cemetery perpetual care trust investment unrealized losses, their associated fair values and the duration of unrealized losses, are shown in the following tables.

	September 30, 2012					
	In Loss Position		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	\$272	\$(1 )	\$—	\$—	\$272	\$(1 )
Canadian government	9,986	(102 )	—	—	9,986	(102 )
Corporate	8,237	(93 )	579	(25 )	8,816	(118 )
Residential mortgage-backed	136	(1 )	—	—	136	(1 )
Equity securities:						
Preferred stock	3,744	(482 )	924	(346 )	4,668	(828 )
Common stock:						
United States	30,487	(1,610 )	10,089	(2,023 )	40,576	(3,633 )
Canada	1,532	(359 )	1,027	(501 )	2,559	(860 )
Other international	3,445	(124 )	1,058	(139 )	4,503	(263 )
Mutual funds:						
Equity	1,014	(28 )	508	(104 )	1,522	(132 )
Fixed income	34,621	(85 )	36,496	(899 )	71,117	(984 )
Private equity	—	—	10,516	(14,052 )	10,516	(14,052 )
Other	—	—	6,125	(3,099 )	6,125	(3,099 )
Total temporarily impaired securities	\$93,474	\$(2,885 )	\$67,322	\$(21,188 )	\$160,796	\$(24,073 )

	December 31, 2011					
	In Loss Position		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:						
Canadian government	\$7,057	\$(43 )	\$—	\$—	\$7,057	\$(43 )
Corporate	3,854	(73 )	1,456	(61 )	5,310	(134 )
Residential mortgage-backed	58	(1 )	127	(12 )	185	(13 )
Asset-backed	51	(1 )	—	—	51	(1 )
Equity securities:						
Preferred stock	4,393	(1,116 )	21	(30 )	4,414	(1,146 )
Common stock:						
United States	39,716	(5,459 )	9,055	(3,654 )	48,771	(9,113 )
Canada	4,402	(772 )	565	(651 )	4,967	(1,423 )
Other international	5,738	(1,226 )	104	(195 )	5,842	(1,421 )
Mutual funds:						
Equity	9,852	(564 )	2,717	(15 )	12,569	(579 )
Fixed income	144,350	(5,498 )	51,301	(3,904 )	195,651	(9,402 )
Private equity	254	(324 )	10,189	(12,413 )	10,443	(12,737 )
Other	140	(181 )	5,660	(1,797 )	5,800	(1,978 )
	\$219,865	\$(15,258 )	\$81,195	\$(22,732 )	\$301,060	\$(37,990 )



Total temporarily impaired securities

## 7. Deferred Preneed Funeral and Cemetery Receipts Held in Trust and Care Trusts' Corpus

### Deferred Preneed Funeral and Cemetery Receipts Held in Trust

We consolidate the merchandise and service trusts associated with our preneed funeral and cemetery activities in accordance with the Consolidation Topic of the ASC. Although the guidance requires the consolidation of the merchandise and service trusts, it does not change the legal relationships among the trusts, us, or our customers. The customers are the legal beneficiaries of these merchandise and service trusts, and therefore their interests in these trusts represent a liability to us.

The components of Deferred preneed funeral and cemetery receipts held in trust in our unaudited condensed consolidated balance sheet at September 30, 2012 and December 31, 2011 are detailed below.

	September 30, 2012			December 31, 2011		
	Preneed Funeral	Preneed Cemetery	Total	Preneed Funeral	Preneed Cemetery	Total
	(In thousands)			(In thousands)		
Trust investments	\$1,328,590	\$1,265,567	\$2,594,157	\$1,271,446	\$1,156,023	\$2,427,469
Accrued trust operating payables and other	(1,531 )	(1,987 )	(3,518 )	(1,261 )	(1,852 )	(3,113 )
Deferred preneed funeral and cemetery receipts held in trust	\$1,327,059	\$1,263,580	\$2,590,639	\$1,270,185	\$1,154,171	\$2,424,356

### Care Trusts' Corpus

The Care trusts' corpus reflected in our unaudited condensed consolidated balance sheet represents the cemetery perpetual care trusts, including the related accrued expenses.

The components of Care trusts' corpus in our unaudited condensed consolidated balance sheet at September 30, 2012 and December 31, 2011 are detailed below.

	September 30, 2012	December 31, 2011
	(In thousands)	
Cemetery perpetual care trust investments	\$1,091,083	\$1,016,506
Accrued trust operating payables and other	(149 )	(1,206 )
Care trusts' corpus	\$1,090,934	\$1,015,300

### Other Income, Net

The components of Other income, net in our unaudited condensed consolidated statement of operations for the three and nine months ended September 30, 2012 and 2011 are detailed below. See Notes 4, 5, and 6 for further discussion of the amounts related to the funeral, cemetery, and cemetery perpetual care trusts.

	Three Months Ended September 30, 2012				
	Funeral Trusts	Cemetery Trusts	Cemetery Perpetual Care Trusts	Other, Net	Total
	(In thousands)				
Realized gains	\$7,681	\$9,754	\$3,328	\$—	\$20,763
Realized losses	(4,570 )	(6,962 )	(1,518 )	—	(13,050 )
Impairment charges	(151 )	(189 )	(4 )	—	(344 )
Interest, dividend, and other ordinary income	2,083	2,247	8,113	—	12,443
Trust expenses and income taxes	(2,288 )	(3,116 )	(727 )	—	(6,131 )
Net trust investment income	2,755	1,734	9,192	—	13,681
Reclassification to deferred preneed funeral and cemetery receipts held in trust and care trusts' corpus	(2,755 )	(1,734 )	(9,192 )	—	(13,681 )
Other income, net	—	—	—	2,317	2,317

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

Total other income, net	\$—	\$—	\$—	\$2,317	\$2,317
-------------------------	-----	-----	-----	---------	---------

Nine Months Ended September 30, 2012

	Funeral Trusts	Cemetery Trusts	Cemetery Perpetual Care Trusts	Other, Net	Total
	(In thousands)				
Realized gains	\$43,446	\$57,636	\$7,522	\$—	\$108,604
Realized losses	(18,730 )	(25,028 )	(5,435 )	—	(49,193 )
Impairment charges	(725 )	(781 )	(258 )	—	(1,764 )
Interest, dividend, and other ordinary income	10,834	8,308	22,170	—	41,312
Trust expenses and income taxes	(7,236 )	(9,367 )	(635 )	—	(17,238 )
Net trust investment income	27,589	30,768	23,364	—	81,721
Reclassification to deferred preneed funeral and cemetery receipts held in trust and care trusts' corpus	(27,589 )	(30,768 )	(23,364 )	—	(81,721 )
Other income, net	—	—	—	4,001	4,001
Total other income, net	\$—	\$—	\$—	\$4,001	\$4,001

Three Months Ended September 30, 2011

	Funeral Trusts	Cemetery Trusts	Cemetery Perpetual Care Trusts	Other, Net	Total
	(In thousands)				
Realized gains	\$11,353	\$10,134	\$4,101	\$—	\$25,588
Realized losses	(6,586 )	(8,758 )	(1,764 )	—	(17,108 )
Impairment charges	(17,533 )	(24,885 )	(5 )	—	(42,423 )
Interest, dividend, and other ordinary income	3,911	4,217	6,185	—	14,313
Trust expenses and income taxes	(2,116 )	(3,119 )	(647 )	—	(5,882 )
Net trust investment income	(10,971 )	(22,411 )	7,870	—	(25,512 )
Reclassification to deferred preneed funeral and cemetery receipts held in trust and care trusts' corpus	10,971	22,411	(7,870 )	—	25,512
Other income, net	—	—	—	249	249
Total other income, net	\$—	\$—	\$—	\$249	\$249

Nine Months Ended September 30, 2011

	Funeral Trusts	Cemetery Trusts	Cemetery Perpetual Care Trusts	Other, Net	Total
	(In thousands)				
Realized gains	\$49,618	\$51,225	\$31,221	\$—	\$132,064
Realized losses	(18,215 )	(19,994 )	(14,506 )	—	(52,715 )
Impairment charges	(20,821 )	(26,081 )	(316 )	—	(47,218 )
Interest, dividend, and other ordinary income	15,085	16,545	25,775	—	57,405
Trust expenses and income taxes	(4,982 )	(7,385 )	(2,753 )	—	(15,120 )
Net trust investment income	20,685	14,310	39,421	—	74,416
Reclassification to deferred preneed funeral and cemetery receipts held in trust and care trusts' corpus	(20,685 )	(14,310 )	(39,421 )	—	(74,416 )
Other income, net	—	—	—	969	969

Total other income, net	\$—	\$—	\$—	\$969	\$969
-------------------------	-----	-----	-----	-------	-------

## 8. Income Taxes

Income tax expense during interim periods is based on our estimated annual effective income tax rate plus any discrete items which are recorded in the period in which they occur. Discrete items include, among others, such events as changes in estimates due to the finalization of tax returns, tax audit settlements, expiration of statute of limitations, and increases or decreases in valuation allowances on deferred tax assets. Our effective tax rate was 34.6% and 20.5% for the three months ended September 30, 2012 and 2011, respectively. Our effective tax rate was 35.8% and 33.5% for the nine months ended September 30, 2012 and 2011, respectively. We sold our Puerto Rican subsidiary in the third quarter of 2011. Our outside tax basis in the business was significantly higher than our book basis. Consequently, we recognized a tax loss that was significantly higher than the book loss on the sale which is permanent in nature. The lower effective tax rate for the three and nine months ended September 30, 2011 is primarily due to that sale.

### Internal Revenue Service Settlement

Our affiliate, SCI Funeral and Cemetery Purchasing Cooperative ("COOP"), is a corporation taxed under subchapter T of the United States Internal Revenue Code, the operation of which has resulted in the deferral of tax payments. The Internal Revenue Service (IRS), in connection with its audits of the COOP's 2003 - 2005 federal income tax returns, proposed adjustments that would accelerate amounts that the Company had previously deferred and would result in the payment of interest on those deferred tax payments. We reached a partial settlement with the IRS in the first quarter of 2012 and as a result the Company made a payment of \$6.6 million which reduced our tax expense by \$3.1 million for the nine months ended September 30, 2012 for adjustments to our "unrecognized tax benefits" – that is, the aggregate tax effect of differences between tax return positions and the benefits recognized in our financial statements, and other tax matters.

### Unrecognized Tax Benefits

As of September 30, 2012, the gross amount of our unrecognized tax benefits was \$146.9 million and the gross amount of our accrued interest was \$40.8 million. During the nine months ended September 30, 2012, our unrecognized tax benefit and gross accrued interest decreased by \$9.4 million and \$1.0 million respectively, due primarily to the conclusion of the IRS audit described above.

A number of years may elapse before particular tax matters, for which we have unrecognized tax benefits, are audited and finally settled. While we have effectively concluded our 2003 - 2005 tax years with respect to our affiliate the COOP, SCI and Subsidiaries' tax years 2003 - 2005 remain under review at the IRS Appeals level and SCI and Subsidiaries' tax years 1999 - 2002 remain under review at the IRS Examination level. Various state and foreign jurisdictions are auditing years through 2009. The outcome of each of these audits cannot be predicted at this time. It is reasonably possible that the amount of our unrecognized tax benefits could significantly increase or decrease over the next twelve months either because we prevail on positions or because the tax authorities prevail. Due to the uncertainty regarding the timing of completion of audits and possible outcomes, a current estimate of the range of increases or decreases that may occur within the next twelve months cannot be made.

## 9. Debt

Debt as of September 30, 2012 and December 31, 2011 was as follows:

	September 30, 2012	December 31, 2011
	(In thousands)	
7.875% Debentures due February 2013	\$4,757	\$4,757
7.375% Senior Notes due October 2014	180,692	180,692
6.75% Senior Notes due April 2015	136,465	136,465
6.75% Senior Notes due April 2016	197,377	197,377
7.0% Senior Notes due June 2017	295,000	295,000
7.625% Senior Notes due October 2018	250,000	250,000
7.0% Senior Notes due May 2019	250,000	250,000

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

8.0% Senior Notes due November 2021	150,000	150,000
7.5% Senior Notes due April 2027	200,000	200,000
Bank credit facility due March 2016	77,000	65,000
Obligations under capital leases	171,427	124,330
Mortgage notes and other debt, maturities through 2047	5,850	35,937
Unamortized pricing discounts and other	(4,445)	(4,888)
Total debt	1,914,123	1,884,670
Less current maturities	(31,289)	(23,554)
Total long-term debt	\$1,882,834	\$1,861,116

Current maturities of debt at September 30, 2012 were primarily comprised of our capital leases. Our consolidated debt had a weighted average interest rate of 6.54% and 6.69% at September 30, 2012 and December 31, 2011, respectively. Approximately 88% and 89% of our total debt had a fixed interest rate at September 30, 2012 and December 31, 2011, respectively.

#### Bank Credit Facility

The Company has a \$500 million bank credit facility due March 2016 with a syndicate of banks, including a sublimit of \$175 million for letters of credit.

As of September 30, 2012, we have \$77.0 million outstanding cash advances under our bank credit facility and have used it to support \$32.4 million of letters of credit. The bank credit facility provides us with flexibility for working capital, if needed, and is guaranteed by a majority of our domestic subsidiaries. The subsidiary guaranty is a guaranty of payment of the outstanding amount of the total lending commitment, including letters of credit. The bank credit facility contains certain financial covenants, including a minimum interest coverage ratio, a maximum leverage ratio, and certain dividend and share repurchase restrictions. We pay a quarterly fee on the unused commitment, which was 0.35% for the third quarter. As of September 30, 2012, we have \$390.6 million in borrowing capacity under the bank credit facility.

#### Debt Extinguishments and Reductions

During the nine months ended September 30, 2012, we paid an aggregate of \$19.3 million to retire capital lease obligations with no associated gain or loss recognized on early extinguishment of this debt.

During the nine months ended September 30, 2011, we paid \$17.2 million to retire capital lease obligations and \$43.1 million to retire \$22.3 million aggregate principal amount of our 6.75% Senior Notes due April 2015, \$16.9 million aggregate principal amount of our 6.75% Senior Notes due April 2016, and \$3.9 million aggregate principal amount of our 7.875% Debentures due February 2013. Certain of the above transactions resulted in the recognition of a loss of \$3.5 million recorded in Losses on early extinguishment of debt, net in our unaudited condensed consolidated statement of operations.

#### Capital Leases

During the nine months ended September 30, 2012 and 2011, we acquired \$67.0 million and \$27.1 million, respectively, of primarily transportation equipment capital leases.

### 10. Credit Risk and Fair Value of Financial Instruments

#### Fair Value Estimates

The fair value estimates of the following financial instruments have been determined using available market information and appropriate valuation methodologies. The carrying values of cash and cash equivalents, trade receivables, and trade payables approximate the fair values of those instruments due to the short-term nature of the instruments. The fair values of receivables on preneed funeral and cemetery contracts are impracticable to estimate because of the lack of a trading market and the diverse number of individual contracts with varying terms.

The fair value of our debt instruments at September 30, 2012 and December 31, 2011 was as follows:

	September 30, 2012	December 31, 2011
	(In thousands)	
7.875% Debentures due February 2013	\$4,757	\$4,971
7.375% Senior Notes due October 2014	199,439	196,954
6.75% Senior Notes due April 2015	150,112	150,083

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

6.75% Senior Notes due April 2016	220,569	216,375
7.0% Senior Notes due June 2017	340,725	323,025
7.625% Senior Notes due October 2018	296,875	276,875
7.0% Senior Notes due May 2019	275,625	262,500
8.0% Senior Notes due November 2021	184,875	167,550
7.5% Senior Notes due April 2027	216,200	195,750
Bank credit facility due March 2016	77,000	65,000
Mortgage notes and other debt, maturities through 2047	5,850	36,340
Total fair value of debt instruments	\$1,972,027	\$1,895,423

The fair values of our long-term, fixed rate loans were estimated using market prices for those loans, and therefore they are classified within Level 1 of the Fair Value Measurements hierarchy as required by the FVM&D Topic of the ASC. The bank credit agreement and the mortgage and other debt are classified within Level 3 of the Fair Value Measurements hierarchy. The fair values of these instruments have been estimated using discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements. A significant increase (decrease) in the inputs results in a directionally opposite change in the fair value of the instruments.

# 11. Share-Based Compensation

## Stock Benefit Plans

We utilize the Black-Scholes option valuation model for estimating the fair value of our stock options. This model uses a range of assumptions related to volatility, the risk-free interest rate, the expected life, and the dividend yield. The fair values of our stock options are calculated using the following weighted average assumptions for the nine months ended September 30, 2012:

Assumptions	Nine Months Ended September 30, 2012	
Dividend yield	1.8	%
Expected volatility	40.8	%
Risk-free interest rate	0.8	%
Expected holding period (in years)	5.0	

## Stock Options

The following table sets forth stock option activity for the nine months ended September 30, 2012:

	Options	Weighted-Average Exercise Price
Outstanding at December 31, 2011	13,404,216	\$ 7.88
Granted	2,035,400	11.17
Exercised	(2,852,880)	6.08
Canceled	(44,600)	\$ 9.61
Outstanding at September 30, 2012	12,542,136	\$ 8.82
Exercisable at September 30, 2012	8,283,698	\$ 8.31

As of September 30, 2012, the unrecognized compensation expense related to stock options of \$8.8 million is expected to be recognized over a weighted average period of 1.4 years.

## Restricted Shares

Restricted share activity for the nine months ended September 30, 2012 was as follows:

	Restricted shares	Weighted-Average Grant-Date Fair Value
Nonvested restricted shares at December 31, 2011	1,165,170	\$ 7.53
Granted	483,170	11.18
Vested	(543,761)	6.21
Nonvested restricted shares at September 30, 2012	1,104,579	\$ 9.78

As of September 30, 2012, the unrecognized compensation expense related to restricted shares of \$6.8 million is expected to be recognized over a weighted average period of 1.4 years.

12. Equity

(All shares reported in whole numbers)

Our components of Accumulated other comprehensive income are as follows:

15

---

Table of Contents

	Foreign Currency Translation Adjustment	Unrealized Gains and Losses  (In thousands)	Accumulated Other Comprehensive Income
Balance at December 31, 2011	\$ 105,852	\$—	\$ 105,852
Activity in 2012	10,979	—	10,979
Increase in net unrealized gains associated with available-for-sale securities of the trusts, net of taxes	—	101,917	101,917
Reclassification of net unrealized gain activity attributable to the Deferred preneed funeral and cemetery receipts held in trust and Care trusts' corpus', net of taxes	—	(101,917 )	(101,917 )
Balance at September 30, 2012	\$ 116,831	\$—	\$ 116,831

The assets and liabilities of foreign operations are translated into U.S. dollars using the current exchange rate. The U.S. dollar amount that arises from such translation, as well as exchange gains and losses on intercompany balances of a long-term investment nature, are included in the foreign currency translation adjustment in Accumulated other comprehensive income.

**Cash Dividends**

On August 7, 2012, our Board of Directors approved a cash dividend of \$.06 per common share. At September 30, 2012, this dividend totaling \$12.8 million was recorded in Accounts payable and accrued liabilities and Capital in excess of par value in our unaudited condensed consolidated balance sheet. This dividend will be paid on October 31, 2012.

**Share Repurchase Program**

Subject to market conditions, normal trading restrictions, and limitations in our debt covenants, we may make purchases in the open market or through privately negotiated transactions under our stock repurchase program. During the nine months ended September 30, 2012, we repurchased 12,226,905 shares of common stock at an aggregate cost of \$142.7 million, which is an average cost per common share of \$11.67. After these repurchases, the remaining dollar value of shares authorized to be purchased under our share repurchase program was approximately \$77.3 million at September 30, 2012.

Subsequent to September 30, 2012, we repurchased an additional 1,416,937 shares of common stock at an aggregate cost of \$19.4 million, which is an average cost per share of \$13.68. After these fourth quarter repurchases, the remaining dollar value of shares authorized to be purchased under our share repurchase program is approximately \$57.9 million.

**13. Segment Reporting**

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

Our reportable segment information is as follows:

	Funeral  (In thousands)	Cemetery	Reportable Segments
Three Months Ended September 30,			
Revenues from external customers:			
2012	\$ 388,365	\$ 192,817	\$ 581,182
2011	\$ 384,003	\$ 188,996	\$ 572,999
Gross profits:			

Edgar Filing: SERVICE CORPORATION INTERNATIONAL - Form 10-Q

2012	\$75,992	\$45,279	\$121,271
2011	\$69,022	\$38,028	\$107,050
Nine Months Ended September 30,			
Revenues from external customers:			
2012	\$1,209,067	\$571,993	\$1,781,060
2011	\$1,178,362	\$551,110	\$1,729,472
Gross profits:			
2012	\$257,703	\$119,324	\$377,027
2011	\$243,827	\$104,692	\$348,519

The following table reconciles gross profits from reportable segments to our consolidated income before income taxes:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Gross profits from reportable segments	\$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

Our geographic area information is as follows:

	United States	Canada	Germany	Total
	(In thousands)			
Three Months Ended September 30,				
Revenues from external customers:				
2012	\$523,600	\$56,280	\$1,302	\$581,182
2011	\$518,754	\$52,824	\$1,421	\$572,999
Nine Months Ended September 30,				
Revenues from external customers:				
2012	\$1,615,128	\$161,411		