SERVICE CORPORATION INTERNATIONAL
Form 10-K/A
October 27, 2005

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K/A
(Amendment No. 2)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2004
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 no.)
1929 Allen Parkway **Houston, Texas**	**77019**
(Address of principal executive offices)	(Zip code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock ($1 par value)	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

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

Indicate by check mark 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 o No þ

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

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

The aggregate market value of the common stock held by non-affiliates of the registrant (assuming that the registrant s only affiliates are its officers and directors) was $2,070,760,397 based upon a closing market price of $7.37 on June 30, 2004 of a share of common stock as reported on the New York Stock Exchange Composite Transactions Tape.

The number of shares outstanding of the registrant s common stock as of March 7, 2005 was 309,972,343 (net of treasury shares).

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement in connection with its 2005 Annual Meeting of Shareholders (Part III)

Table of Contents

Explanatory Note:
The Company has amended and restated its 2004 Form 10-K/A (Amendment No. 1) filed April 7, 2005 to restate its consolidated financial statements as of December 31, 2004 and 2003 and for each of the three years in the period ended December 31, 2004. In addition, the Company has restated its selected financial data as of December 31, 2002, 2001 and 2000, and for each of the two years in the period ended December 31, 2001, as included in Item 6. Selected Financial Data. The Company has also restated its unaudited quarterly financial data for each of the interim periods of 2004 and 2003, as included in Note twenty-two of the consolidated financial statements. Included in this Form 10-K/A (Amendment No. 2) are certain adjustments to correct errors related to (1) the Company s recognition of income related to its preneed funeral and cemetery trust accounts, (2) preneed funeral trust income that was previously understated as a result of a point-of-sale system error, and (3) the computation of gains and losses on certain asset divestiture activities, including the write-off of certain covenant-not-to-compete agreements which should have been recognized in the Company s 2002 consolidated financial statements. All applicable amounts relating to this restatement have been reflected in the consolidated financial statements and disclosed in the notes to the consolidated financial statements in this Form 10-K/A (Amendment No. 2). This Form 10-K/A (Amendment No. 2) includes amounts related to the Company s prior restatement of its consolidated financial statements and financial statement schedule which was contained in the Company s 2004 Form 10-K filing, as amended on April 7, 2005 (Amendment No. 1).

SERVICE CORPORATION INTERNATIONAL
INDEX

Table of Contents

PART I

ITEM 1. *Business.*

General

At December 31, 2004, Service Corporation International (SCI or the Company) owned and operated 1,216 funeral service locations and 400 cemeteries. Complementary to our funeral operations, we own and operate Kenyon International Emergency Services, a disaster response company that engages in mass fatality and emergency response services.

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

During the first quarter of 2004, we sold our funeral operations in France and subsequently purchased a 25% equity interest in the acquiring entity. We sold our minority interest investment in our United Kingdom operations in the second quarter of 2004. For additional information regarding these transactions, see note twenty to the consolidated financial statements in Item 8 of this amended Form 10-K/A. During the first quarter of 2005, we disposed of our operations in Argentina and Uruguay, which were accounted for as discontinued operations at December 31, 2004. See note twenty-one to the consolidated financial statements in Item 8 of this amended Form 10-K/A for additional information related to discontinued operations.

SCI was incorporated in Texas in July of 1962. Our principal corporate offices are located at 1929 Allen Parkway, Houston, Texas 77019 and our telephone number is (713) 522-5141. Our website is http://www.sci-corp.com. We make available free of charge, on or through our website, our annual, quarterly and current reports and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission.

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

Funeral and Cemetery Operations

General

The funeral and cemetery operations consist of our funeral service locations, cemeteries, crematoria and related businesses. In 2004, our operations were organized into a North America division, which represents the United States and Canada, a European division primarily consisting of operations in France and Germany and an Other Foreign division relating to operations in South America and Singapore. See note seventeen to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2) for financial information about our business segments.

Our operations in North America are organized into 32 major markets and 42 middle markets. Each market is led by a market director with responsibility for funeral and cemetery operations and preneed sales. Within each market, the funeral homes and cemeteries realize efficiencies by sharing common resources such as personnel, preparation services, and vehicles. There are three market support centers in North America to assist market directors with financial, administrative and human resource needs. These support centers are located in Houston, New York, and Los Angeles. The primary functions of the market support centers are to help facilitate the execution of corporate strategies, coordinate communication between the field and corporate offices, and serve as liaisons for implementation of policies and procedures.

Table of Contents

The death care industry in North America is characterized by a large number of locally owned, independent operations. In order to be successful, we believe our funeral service locations and cemeteries must maintain good reputations and high professional standards in the industry, as well as offer attractive products and services at competitive prices. We believe we have an unparalleled network of funeral service locations and cemeteries that offer high quality products and services at prices that are competitive with local competing funeral homes, cemeteries, and retail locations.

We have multiple funeral service locations and cemeteries in a number of metropolitan areas. Within individual metropolitan areas, the funeral service locations and cemeteries operate under various names as most operations were acquired as existing businesses. Some of our international funeral service locations operate under certain brand names specific for a general area or country. We have branded our funeral operations in North America under the name Dignity Memorial®. A national brand name is unique to the death care industry in North America and we believe this gives us a strategic advantage in the industry. While this branding process is intended to emphasize our seamless national network of funeral service locations and cemeteries, the original names associated with acquired operations, and their inherent goodwill and heritage, will generally remain the same. For example, Geo. H. Lewis & Sons Funeral Directors is now Geo. H. Lewis & Sons Funeral Directors, a Dignity Memorial® provider.

In the death care industry, there has been a growing trend in the number of cremations performed in North America as an alternative to traditional funeral service dispositions. The west coast of the United States, Florida and Arizona have the highest concentration of cremation consumers in North America. Cremation services usually result in lower revenue and gross profit dollars than traditional funeral services. In North America during 2004, 40.0% of all funeral services we performed were cremation cases, compared to 39.0% performed in 2003. We have expanded our cremation memorialization products and services in several North America markets, which has resulted in higher average sales for cremation cases compared to historical levels. We also continue to own and operate National Cremation® Service (NCS), our nationally branded cremation company with multiple locations in 16 states and Ontario, Canada at December 31, 2004.

Prior to 1999, we focused on the acquisition and consolidation of independent funeral homes and cemeteries in the fragmented death care industry in North America. During the 1990 s, we also expanded our operations through acquisitions in Europe, Australia, South America and the Pacific Rim. At one time, our network consisted of more than 4,500 businesses in 20 countries on 5 continents. During the mid to late 1990 s, the acquisition market became extremely competitive resulting in increased prices for acquisitions and substantially reduced returns on invested capital. In 1999, we significantly reduced the level of acquisition activity and focused on identifying and addressing non-strategic or underperforming businesses. This focus resulted in the divestiture of several North America and international operations. During 2002 and 2001, we completed joint ventures of operations in Australia, United Kingdom, Spain and Portugal. In 2003, we sold our equity investment in our operations in Australia, Spain and Portugal. During the first quarter of 2004, we completed a joint venture of our funeral operations in France. We sold our minority interest equity investment in the United Kingdom in the second quarter of 2004. During the first quarter of 2005, we divested of all of our operations in Argentina and Uruguay. We may pursue discussions with various third parties concerning the sale or joint venture of our remaining international operations as we intend to focus our efforts on operating a core business of high quality funeral service locations and cemeteries in North America.

Funeral Service Locations

Our 1,216 funeral service locations provide all professional services relating to funerals, including the use of funeral facilities, motor vehicles, and preparation and embalming services. Funeral service locations sell caskets, burial vaults, cremation receptacles, flowers, burial garments, and other ancillary products and services. Primary costs associated with our funeral service locations include labor, facility costs, vehicle costs and cost of merchandise. Our funeral service locations generally experience a greater demand for services in the winter months primarily related to higher incidents of deaths from pneumonia and influenza.

In addition to selling products and services to client families at the time of need, we also sell preneed funeral services in most of our service markets. A preneed funeral arrangement is a means through which a customer agrees to the terms of a funeral to be performed in the future. All or a portion of the funds collected from preneed funeral contracts are placed into trust accounts, pursuant to applicable law. Alternatively, where allowed, customers may choose to purchase a life insurance or annuity policy from third party insurance companies to fund their preneed funerals. In certain situations and pursuant to applicable laws, we will post a surety bond as financial assurance for a certain amount of the preneed funeral contract in lieu of placing certain funds in trust accounts. See the *Financial Assurances* section included in Financial Condition, Liquidity and Capital Resources in Item 7 of this amended Form 10-K/A for further details on our practice of posting such surety bonds. For additional information regarding preneed funeral activities, see the *Preneed Funeral and Cemetery Activities* section in Financial Condition, Liquidity and Capital Resources in Item 7 and notes three, four and five to the consolidated financial statements in Item 8 of this amended Form 10-K/A.

Cemeteries

Our 400 cemeteries sell interment rights associated with cemetery properties such as mausoleum spaces, lots and lawn crypts, and sell cemetery merchandise such as stone and bronze memorials, burial vaults, caskets and cremation memorialization products. Our cemeteries perform interment services and provide management and maintenance of cemetery grounds. Certain cemeteries operate crematoria and certain cemeteries contain gardens specifically for the purpose of cremation memorialization. Primary costs associated with our cemetery operations include labor costs, selling costs, cost of merchandise (including cemetery property), and maintenance costs.

Cemetery sales are often made on a preneed basis pursuant to installment contracts providing for monthly payments. A portion of the proceeds from cemetery contracts is generally required by law to be paid into perpetual care trust funds. Earnings from perpetual care trust funds are used to defray the maintenance costs of cemeteries. Additionally, all or a portion of the proceeds from the sale of preneed cemetery merchandise and services may be required by various state laws to be paid into merchandise and services trusts until the merchandise is delivered or the service is provided. In certain situations and pursuant to applicable laws, we will post a surety bond as financial assurance for a certain amount of the preneed cemetery contract in lieu of placing certain funds into trust accounts. See the *Financial Assurances* section included in Financial Condition, Liquidity and Capital Resources in Item 7 of this Form 10-K/A (Amendment No. 2) for further details on the practice of posting such surety bonds. For additional information regarding cemetery preneed activities, see the *Preneed Funeral and Cemetery Activities* section in Financial Condition, Liquidity and Capital Resources in Item 7 of this Form 10-K/A (Amendment No. 2) and notes three, four and six to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2).

Combined Funeral Service Locations and Cemeteries

We own 189 funeral service/cemetery combination locations in which a funeral service location is physically located within or adjoining an SCI owned cemetery. Combination locations allow certain facility, personnel, and equipment costs to be shared between the funeral service location and cemetery and typically have a higher gross margin than if the funeral and cemetery operations were operated separately. Combination locations also create synergies between funeral and cemetery sales force personnel and give consumers added convenience to purchase both funeral and cemetery products and services at a single location.

Employees

At December 31, 2004, we employed 13,939 (12,535 in North America) individuals on a full time basis and 6,659 (6,637 in North America) individuals on a part time basis. Of the full time employees, 13,410 were employed in the funeral and cemetery operations and 529 were employed in corporate or other overhead activities and services. All eligible employees in the United States who so elect are covered by SCI s group health and life insurance plans. Eligible employees in the United States are participants in retirement plans of SCI or various subsidiaries, while international employees are covered by other SCI (or SCI subsidiary) defined or government mandated benefit plans. Approximately 5% of our employees in North America are represented by unions. Although labor disputes are experienced from time to time, relations with employees are generally considered favorable.

Regulation

Our operations are subject to regulations, supervision and licensing under numerous foreign, federal, state and local laws, ordinances and regulations, including extensive regulations concerning trust funds, preneed sales of funeral and cemetery products and services and various other aspects of our business. We comply in all material respects with the provisions of such laws, ordinances and regulations. Since 1984, we have operated in the United States under the Federal Trade Commission (FTC) comprehensive trade regulation rule for the funeral industry. The rule contains requirements for funeral industry practices, including extensive price and other affirmative disclosures and imposes mandatory itemization of funeral goods and services. From time to time in connection with our former strategy of growth through acquisitions, we entered into consent orders with the FTC that required us to dispose of certain operations in order to proceed with such acquisitions, or limited our ability to make acquisitions in specified areas. The trade regulation rule and the various consent orders have not had a material adverse effect on our operations.

ITEM 2. *Properties.*

Our corporate headquarters are located at 1929 Allen Parkway, Houston, Texas 77019. A wholly-owned subsidiary of SCI owns an undivided one-half interest in the building and parking garage. The other undivided one-half interest is owned by an unrelated third party. We plan to acquire the other one-half interest in the building at the end of the lease in July 2005 for $2 million. The property consists of approximately 127,000 square feet of office space and 185,000 square feet of parking space. We lease all of the office space in the building for $59,000 per month and pay all operating expenses. One half of the rent is paid to the wholly-owned subsidiary and the other half is paid to the owners of the remaining undivided one-half interest. We own and utilize two additional buildings located in Houston, Texas for corporate activities containing a total of approximately 207,000 square feet of office space.

Table of Contents

At December 31, 2004, we owned approximately 82% of the real estate and buildings used by our 1,216 funeral service locations, 400 cemeteries and 145 crematoria, and 18% of such facilities were leased. In addition, we leased two aircraft pursuant to cancelable operating leases. At December 31, 2004, we operated 6,066 vehicles, of which 15% were owned and 85% were leased. For additional information regarding leases, see the *Contractual, Commercial and Contingent Commitments* section in Financial Condition, Liquidity and Capital Resources in Item 7 and note fourteen to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2).

At December 31, 2004, our 400 cemeteries contained a total of approximately 28,563 acres, of which approximately 57% was developed.

The specialized nature of our businesses requires that our facilities be well-maintained and kept in good condition and we believe that these standards are being met.

The following table provides the number of SCI funeral homes and cemeteries by state and country as of December 31, 2004:

Country	Number of funeral homes	Number of cemeteries
United States		
Alabama	31	16
Alaska	7	2
Arizona	27	10
Arkansas	8	5
California	110	35
Colorado	29	11
Connecticut	17	0
District of Columbia	1	0
Florida	124	43
Georgia	24	12
Hawaii	2	2
Illinois	57	17
Indiana	25	9
Iowa	7	4
Kansas	9	4
Kentucky	16	5
Louisiana	27	5
Maine	17	0
Maryland	13	11
Massachusetts	31	0
Michigan	17	12
Minnesota	7	4
Mississippi	11	2
Missouri	25	8
Nebraska	4	0
New Hampshire	3	0
New Jersey	23	0
New Mexico	5	1
New York	62	0
North Carolina	28	15
Ohio	18	14
Oklahoma	15	8
Oregon	24	12

Pennsylvania	17	25
Rhode Island	1	0
South Carolina	2	4
South Dakota	2	0
Tennessee	20	12
Texas	132	45
Utah	5	3
Vermont	1	0
Virginia	17	12
Washington	23	9
West Virginia	4	6
Wisconsin	12	0

Table of Contents

Country	Number of funeral homes	Number of cemeteries
Canada		
Alberta	15	1
British Columbia	23	5
New Brunswick	5	0
Nova Scotia	5	0
Ontario	29	0
Quebec	49	0
Saskatchewan	4	1
Argentina	5(1)	5(1)
Chile	0	3
Germany	17	0
Singapore	4	0
Uruguay	0	2(1)
Total	1,216	400

(1) These businesses were sold in February 2005.

ITEM 3. ***Legal Proceedings.***

Information regarding legal proceedings is set forth in note fourteen to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2).

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

None.

EXECUTIVE OFFICERS OF THE COMPANY

Pursuant to General Instruction G to Form 10-K, the information regarding executive officers of the Company called for by Item 401 of Regulation S-K is hereby included in Part I of this report.

The following table sets forth as of March 14, 2005 the name and age of each executive officer of the Company, the office held, and the date first elected an officer.

Officer Name	Age	Position	Year First Became Officer(1)
R. L. Waltrip	74	Chairman of the Board	1962
Thomas L. Ryan	39	President and Chief Executive Officer	1999
Michael R. Webb	46	Executive Vice President and Chief Operating Officer	1998
Jeffrey E. Curtiss	56	Senior Vice President Chief Financial Officer and Treasurer	2000
J. Daniel Garrison	53	Senior Vice President Operations Support	1998
Stephen M. Mack	53	Senior Vice President Middle Market Operations	1998
James M. Shelger	55	Senior Vice President General Counsel and Secretary	1987
Christopher H. Cruger	30	Vice President Business Development	2005
W. Cardon Gerner	50	Vice President Accounting	1999

Jane Jones	49	Vice President Human Resources	2005
Albert R. Lohse	44	Vice President Corporate Governance	2004
Elisabeth G. Nash	44	Vice President Continuous Process Improvement	2004
Donald R. Robinson	47	Vice President Supply Chain Management	2005
Eric D. Tanzberger	36	Vice President and Corporate Controller	2000
Sumner J. Waring, III	36	Vice President Major Market Operations	2002

(1) Indicates the year a person was first elected as an officer although there were subsequent periods when certain persons ceased being officers of the Company.

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

Mr. Waltrip is the founder, Chairman of the Company, and a licensed funeral director. He grew up in his family s funeral business and assumed management of the firm in the 1950s after earning a Bachelor s degree in Business Administration from the University of Houston. He began buying additional funeral homes in the 1960s, achieving cost efficiencies by pooling their resources. At the end of 2004, the network he began had grown to include more than 1,700 funeral service locations, cemeteries and crematoria. Mr. Waltrip took the Company public in 1969. He has provided leadership to the Company for over 40 years.

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

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

Mr. Curtiss joined the Company as Senior Vice President and Chief Financial Officer in January 2000. In August 2002, Mr. Curtiss responsibilities changed to include the responsibilities of Treasurer of the Company. From January 1992 until July 1999, Mr. Curtiss served as Senior Vice President and Chief Financial Officer of Browning-Ferris Industries, a waste services company. Mr. Curtiss attended the University of Nebraska, Lincoln, where he earned Bachelor of Science in Business Administration and Doctor of Jurisprudence degrees. He also holds a Master of Legal Letters degree in taxation from Washington University in St. Louis, Missouri. Mr. Curtiss is also a Certified Public Accountant.

Mr. Garrison joined the Company in 1978 and worked in a series of management positions until he was promoted to President of the Southeastern Region in 1992. In 1998, Mr. Garrison was promoted to Corporate Vice President in charge of operations outside North America. In 2000, Mr. Garrison was promoted to Vice President North American Cemetery Operations. Mr. Garrison was promoted to Vice President Operations Services in August 2002. He served in this position until assuming his current position as Senior Vice President Operations Support in February 2005. Mr. Garrison is an Administrative Management graduate of Clemson University.

Mr. Mack joined the Company in 1973 as a resident director after graduating from Farmingdale State University of New York. He became Vice President of the Eastern Region in 1987 and Regional President in 1992. Mr. Mack was appointed Corporate Vice President in 1998 and then promoted to Senior Vice President in 2002. Mr. Mack was promoted to Senior Vice President Eastern Operations in August 2002 and assumed the office of Senior Vice President Middle Market Operations in November 2003.

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

Mr. Cruger oversees Corporate Development and the Dignity Memorial® affiliate network of independent funeral homes. He initially served SCI as a financial analyst in the corporate development department from 1996 until 1999, when he left to become Manager of Financial Analysis for R. H. Donnelley Corporation. During 2000, he became

Vice President of BestHalf.com, an internet company dedicated to senior citizen issues, before returning to SCI as Director of European Corporate Development in France. Since 2003, he served as Managing Director of Corporate Development. In February 2005, he was promoted to Vice President of Business Development. Mr. Cruger graduated from Lehigh University with a Bachelor of Science in Finance.

Mr. Gerner joined the Company in January 1999 in connection with the acquisition of Equity Corporation International (ECI) and in March 1999 was promoted to Vice President Corporate Controller. In August 2002, Mr. Gerner s responsibilities and position changed to Vice President Accounting. Before the acquisition, Mr. Gerner had been Senior Vice President and Chief Financial Officer of ECI since March 1995. Prior thereto, Mr. Gerner was a partner with Ernst & Young LLP. Mr. Gerner graduated with honors from the University of Texas-Austin, with a Bachelor of Business Administration in Accounting. Mr. Gerner is also a Certified Public Accountant.

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

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

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

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

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

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

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

PART II

ITEM 5. ***Market for the Company s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***

Our common stock has been traded on the New York Stock Exchange since May 14, 1974. On December 31, 2004, there were 6,105 holders of record of our common stock. At December 31, 2004, we had 323,225,352 shares outstanding, net of treasury shares.

In October 1999, we suspended payment of regular quarterly cash dividends on our outstanding common stock in order to focus on improving cash flow and reducing existing debt. On February 10, 2005, our Board of Directors approved the initiation of a quarterly cash dividend of $.025 per common share. The first dividend is payable on April 29, 2005 to shareholders of record at April 15, 2005. While we intend to pay regular quarterly cash dividends for the foreseeable future, all subsequent dividends are subject to final determination by the Board of Directors of SCI each quarter after its review of our financial performance.

Table of Contents

The table below shows our quarterly high and low common stock prices for the two years ended December 31, 2004:

	2004		2003	
	High	Low	High	Low
First quarter	$ 7.64	$ 5.48	$ 3.82	$ 2.78
Second quarter	7.69	7.03	4.24	2.67
Third quarter	7.30	5.90	4.95	3.75
Fourth quarter	7.45	6.18	5.58	4.45

On August 27, 2004, we changed our New York Stock Exchange ticker symbol for our common stock from SRV to SCI. Options in our common stock are traded on the Philadelphia Stock Exchange under the symbol SCI.

For equity compensation plan information, see Part III of this report.

On August 16, 2004, we announced a share repurchase program authorizing the investment of up to $100 million to repurchase our common stock. On November 10, 2004, we announced an increase in the share repurchase program authorizing the investment of up to an additional $100 million to repurchase our common stock. Pursuant to the program, we have repurchased shares of our common stock as set forth in the table below. As of December 31, 2004, these purchases totaled $110.3 million.

	Issuer purchases of equity securities			
	(a)	(b)	(c)	(d)
Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced programs	Dollar value of shares that may yet be purchased under the programs
October 1, 2004 October 31, 2004	3,908,400	$ 6.3029	3,908,400	$ 40,554,201
November 1, 2004 November 30, 2004	1,130,760	$ 6.8384	1,130,760	$ 132,821,585
December 1, 2004 December 31, 2004	6,074,712	$ 7.0916	6,074,712	$ 89,741,915
	11,113,872	$ 6.7885	11,113,872	$ 89,741,915

Subsequent to December 31, 2004, we announced an increase in the share repurchase program authorizing the investment of up to an additional $100 million to repurchase our common stock for an aggregate of $300 million. From January 1, 2005 to March 31, 2005, we repurchased 14.7 million shares for a total cost of $103.5 million. As of March 31, 2005, the remaining dollar value of shares that may yet be purchased under our share repurchase programs was approximately $86 million.

ITEM 6. *Selected Financial Data.*

The table below contains selected consolidated financial data for the years ended December 31, 2000 through December 31, 2004. We have amended and restated herein our previously filed 2004 Form 10-K/A (Amendment No. 1) filed on April 7, 2005 to correct errors related to (1) the recognition of income related to preneed funeral and cemetery trust accounts, (2) preneed funeral trust income that was previously understated as a result of a point-of-sale system error, and (3) the computation of gains and losses on certain asset divestiture activities, including the write-off of certain covenant-not-to-compete agreements which should have been recognized in the Company s 2002 consolidated financial statements. In connection with this restatement, we restated our previously reported financial statements and selected financial data for each of the five fiscal years ended December 31, 2004. All applicable amounts related to these restatements are reflected in the selected consolidated financial data below. See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and notes two and twenty-two to the consolidated financial statements in Item 8 of Form 10-K/A (Amendment No. 2) for details of these restatements. The statement of operations data also includes reclassifications of certain other items to conform to current period presentations with no impact on net income or financial position. In the second quarter of 2004, we committed to a plan to divest our existing funeral and cemetery operations in Argentina and Uruguay. Subsequent to December 31, 2004, we sold our businesses in Argentina and Uruguay. These operations are classified as discontinued operations for all periods presented. In the first quarter of 2004, we changed our method of accounting for insurance funded preneed contracts as we have concluded that our insurance funded preneed funeral contracts are not assets and liabilities of the Company. Therefore, we have removed from our consolidated balance sheet amounts relating to insurance funded preneed funeral contracts for all periods presented. The data set forth should be read in conjunction with our consolidated financial statements and accompanying notes to the consolidated financial statements included in this Form 10-K/A (Amendment No. 2). This historical information is not necessarily indicative of the results to be expected in the future.

In 2002, we adopted Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). SFAS 142 addresses accounting for goodwill and other intangible assets and redefines useful lives, amortization periods and impairment of goodwill. Under the pronouncement, goodwill is no longer amortized, but is tested for impairment annually by assessing the fair value of reporting units, generally one level below reportable segments. As a result of the adoption of SFAS 142, we recognized a non-cash charge in 2002 reflected as a cumulative effect of accounting change of $135.6 million, net of applicable taxes, related to the impairment of goodwill in our North America cemetery reporting unit. For more information regarding goodwill, see note nine to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2).

In 2000, we implemented Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements* (SAB 101). As a result of this implementation, we changed certain of our accounting policies regarding preneed sales activities. We recorded the charge as a cumulative effect of accounting change of $870.4 million (as restated), net of applicable taxes, as of January 1, 2000.

Selected Consolidated Financial Information

	Year ended December 31,				
(Dollars in millions, except per share amounts)	**2004** (Restated)	**2003** (Restated)	**2002** (Restated)	**2001** (Restated)	**2000** (Restated)
Selected Consolidated Statements of Operations Data:					
Revenue	$ 1,860.9	$ 2,338.1	$ 2,310.9	$ 2,489.1	$ 2,571.6
Income (loss) from continuing operations before cumulative effects of accounting changes	$ 117.9	$ 82.5	$ (84.3)	$ (462.7)	$ (387.4)
Net income (loss)	$ 114.1	$ 85.1	$ (234.6)	$ (622.2)	$ (1,293.1)
Earnings (loss) per share:					
Income (loss) from continuing operations before cumulative effects of accounting changes					
Basic	$ .37	$ 0.28	$ (0.29)	$ (1.62)	$ (1.42)
Diluted	$ .36	$ 0.27	$ (0.29)	$ (1.62)	$ (1.42)
Net income (loss)					
Basic	$ .36	$ 0.28	$ (0.80)	$ (2.18)	$ (4.75)
Diluted	$ .35	$ 0.28	$ (0.80)	$ (2.18)	$ (4.75)
Selected Consolidated Balance Sheet Data:					
Total assets	$ 8,205.7	$ 7,562.9	$ 7,793.1	$ 9,020.5	$ 10,518.9
Long-term debt, less current maturities	$ 1,178.9	$ 1,519.2	$ 1,874.1	$ 2,301.4	$ 3,078.7
Stockholders equity	$ 1,848.7	$ 1,521.6	$ 1,321.3	$ 1,453.2	$ 2,020.5

ITEM 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations.***

Restatement of Financial Statements

Overview

We have restated our previously issued consolidated financial statements as of December 31, 2004 and 2003 and for each of the three years in the period ended December 31, 2004 and our unaudited quarterly financial data for each of the interim periods of 2004 and 2003. This restatement corrects errors related to (1) our recognition of income related to our preneed funeral and cemetery trust accounts, (2) preneed funeral trust income that was previously understated as a result of a point-of-sale system error, and (3) the computation of gains and losses on certain asset divestiture activities, including the write-off of certain covenant-not-to-compete agreements which should have been recognized in our 2002 consolidated financial statements.

We had previously restated our unaudited quarterly financial data for the first three quarters of 2004 by including such restated financial statements in our initial 2004 Form 10-K. Such errors related to (1) the recognition of deferred preneed cemetery contract revenues, (2) certain reconciliations of our preneed funeral and cemetery trust assets and deferred revenues, and (3) operating leases and other account reconciliations. At that time, we concluded that the net aggregate impact of such errors related to periods prior to January 1, 2004 was not material to our consolidated financial statements or to the first quarter of 2004, nor for any quarterly or annual period prior to January 1, 2004, and as a result, we recorded the net aggregate impact of such errors (a $0.4 million increase to pre-tax income) in *Other operating (expense) income* as a correction of an immaterial error in the first quarter of 2004. However, in light of the material impact of the errors identified in the second quarter of 2005, as described in the previous paragraph, we have concluded that the Current Period Restatement should reflect the $0.4 million net impact of these errors, previously reported as *Other operating (expense) income,* in the restatement of our prior period financial statements for the fiscal years ended 2004, 2003, and 2002, and the restatement of our unaudited quarterly financial data for each of the interim periods of 2004 and 2003.

Current Period Restatement

Preneed Funeral and Cemetery Trust Verification and Reconciliation Project

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

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

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

By March 2005, we completed our examination of the 430,000 preneed funeral contracts and had also implemented the reconciliation procedures described above, which resulted in the identification of a significant number of reconciling items. In light of these reconciling items, we reevaluated previous adjustments related to these projects and the impact to previously issued financial statements. We determined that these adjustments had a material impact on our consolidated financial data for the first three interim periods of 2004. As a result, we restated our unaudited quarterly financial statements for the first three interim periods of 2004 in our original Form 10-K. We evaluated the materiality of these adjustments on our consolidated financial statements issued prior to January 1, 2004 and concluded that the impact of these adjustments was not material to the fiscal period ended 2004 or to any quarterly or annual period prior to January 1, 2004. As a result, we recorded the net aggregate effect of these adjustments ($0.4 million increase to pretax income) in *Other operating income (expense)* in our restated first quarter 2004 financial statements as a correction of an error.

During the first and second quarters of 2005, we continued to find and record these reconciling items to our trust asset and deferred revenue detailed records. During the second quarter of 2005, we determined that certain of the reconciling items had been reflected improperly in our initial reconciliation process at December 31, 2004, which resulted in the identification of additional errors to our consolidated financial statements. We recorded a $1.6 million charge in our first quarter 2005 consolidated financial statements for similar prior period adjustments arising from the aforementioned reconciliation process.

Also during the second quarter of 2005, we identified other adjustments, one of which related to a point-of-sale system error that caused preneed funeral trust income accounts to be understated in the fourth quarter of 2004 by $1.6 million, and another of which related to improper computation of gains and losses on asset divestiture activities. In connection with the asset divestitures we failed to write off certain covenant-not-to-compete agreements, which should have been recorded in our 2002 consolidated financial statements.

Operating Leases and Other Account Reconciliations

We initiated a review of our accounting practices and determined that we should adjust our method of accounting for certain types of operating leases related primarily to our funeral home properties.

Historically, we have recorded operating lease expense, related primarily to funeral home properties, over the initial lease term without regard to reasonably assured renewal options or fixed escalation provisions. We will now calculate our straight-line operating lease expense over the lease term (including certain renewals options and fixed escalation provisions, to the extent necessary) in accordance with SFAS 13, *Accounting for Leases* .

During 2004, we also performed various other reconciliations. These reconciliations primarily resulted from the conversion of our point-of-sale system.

Materiality Assessment

We evaluated the materiality of these adjustments (including the $1.6 million charge recorded in the first quarter 2005 and the adjustments aggregating to $0.4 million associated with the restatement of the first three interim periods of 2004 described above) as of December 31, 2004 and 2003 and for each of the three years in the period ended December 31, 2004. We determined that the net effect of these adjustments ($7.0 million charge to pretax income), which primarily related to periods prior to 2000, was not material to our previously reported consolidated financial statements for the periods described above; however, we determined that such impact was material to our second quarter 2005 consolidated financial statements. As a result, we have restated our 2004, 2003 and 2002 consolidated financial statements as well as our quarterly financial data for the first quarter of 2005 and all quarters of 2004 and 2003. The effect of each of these restatement items is individually immaterial to net income and earnings per share for periods presented.

Table of Contents

Effect on Annual Periods

The effect of these adjustments on our consolidated statement of operations for the years ended December 31, 2004, 2003 and 2002 is detailed as follows:

(In thousands)

	For the year ended December 31, 2004	
	As Reported	As Restated
Revenues	$ 1,859,308	$ 1,860,862
Costs and expenses	1,524,810	1,524,652
Gross profits	334,498	336,210
Gains and impairment (losses) on dispositions, net	25,628	25,797
Operating income	229,646	231,111
Income from continuing operations before income taxes and cumulative effects of accounting changes	110,798	112,263
Benefit for income taxes	(6,213)	(5,659)
Cumulative effect of accounting changes, net	(47,074)	(47,556)
Net income	$ 113,699	$ 114,128
Earnings per share:		
Basic EPS	$ .36	$ .36
Diluted EPS	$ .35	$ .35

	For the year ended December 31, 2003		For the year ended December 31, 2002	
	As Reported	As Restated	As Reported	As Restated
Revenues	$ 2,328,425	$ 2,338,062	$ 2,312,439	$ 2,310,880
Costs and expenses	1,966,460	1,976,503	1,950,430	1,950,681
Gross profits	361,965	361,559	362,009	360,199
Gains and impairment (losses) on dispositions, net	49,366	49,727	(161,510)	(163,152)
Operating income	224,222	224,177	15,837	12,385
Income (loss) from continuing operations before income taxes and cumulative effects of accounting changes	111,219	111,174	(119,850)	(123,302)
Provision (benefit) for income taxes	28,666	28,638	(37,692)	(38,992)
Net income (loss)	$ 85,082	$ 85,065	$ (232,486)	$ (234,638)
Earnings (loss) per share:				
Basic EPS	$ .28	$ .28	$ (.79)	$ (.80)
Diluted EPS	$ .28	$ .28	$ (.79)	$ (.80)

The effect of the restatement on our previously reported consolidated balance sheet as of December 31, 2004 and 2003 is as follows:

(In thousands)

	December 31, 2004		December 31, 2003	
	As Reported	As Restated	As Reported	As Restated
Selected consolidated balance sheet data:				

Receivables, net of allowances	$ 102,156	$ 102,622	$ 229,839	$ 229,839
Total current assets	533,497	533,963	673,324	673,277
Preneed funeral receivables and trust investments	1,264,600	1,267,784	1,229,765	1,080,108
Preneed cemetery receivables and trust investments	1,402,750	1,399,778	1,083,035	1,068,216
Deferred charges and other assets	618,565	621,561	738,011	742,160
Total assets	8,199,196	8,205,687	7,725,204	7,562,903
Deferred preneed funeral revenues	486,191	498,571	1,612,347	1,464,218
Deferred preneed cemetery revenues	801,065	803,144	1,575,352	1,551,187
Deferred income taxes	279,474	276,572	418,375	415,208
Non-controlling interest in funeral and cemetery trusts	2,095,852	2,092,881		
Accumulated deficit	824,364	829,244	938,063	943,372
Total stockholders equity	1,853,576	1,848,667	1,526,958	1,521,620
Total liabilities and stockholders equity	8,199,196	8,205,687	7,725,204	7,562,903

Effect of Restatement on Quarterly Information

The effect of these adjustments on our quarterly financial data for each of the four quarters in both 2004 and 2003 are presented below. As discussed in Current Period Restatement, the quarterly financial data for the first three interim periods of 2004 has been further restated in connection with this restatement.

(In thousands)

	Three months ended December 31, 2004 (Unaudited)		**Three months ended September 30, 2004** (Unaudited)	
	As Reported	**As Restated**	**As Reported**	**As Restated**
Revenues	$ 433,226	$ 435,064	$ 404,557	$ 404,731
Costs and expenses	358,180	358,141	334,463	334,422
Gross profits	75,046	76,923	70,094	70,309
Gains and impairment (losses) on dispositions, net	(7,390)	(7,224)	(3,281)	(3,281)
Operating income	37,107	39,150	41,515	41,730
Income from continuing operations before income taxes	16,939	18,982	18,196	18,411
(Benefit) provision for income taxes	(560)	205	4,739	4,819
Net income	$ 25,886	$ 27,164	$ 13,741	$ 13,876
Earnings per share:				
Basic EPS	$ .08	$ .08	$ .04	$ .04
Diluted EPS	$ .08	$ .08	$ .04	$ .04

	Three months ended June 30, 2004 (Unaudited)		**Three months ended March 31, 2004** (Unaudited)	
	As Reported	**As Restated**	**As Reported**	**As Restated**
Revenues	$ 432,103	$ 432,368	$ 589,422	$ 588,699
Costs and expenses	359,058	359,019	473,109	473,070
Gross profits	73,045	73,349	116,313	115,629
Gains and impairment (losses) on dispositions, net	1,517	1,517	34,782	34,785
Operating income	50,534	50,838	100,490	99,393
Income from continuing operations before income taxes and cumulative effects of accounting changes	1,407	1,711	74,256	73,159
Benefit for income taxes	(7,017)	(6,904)	(3,375)	(3,779)
Net income	$ 42,761	$ 42,952	$ 31,311	$ 30,136
Earnings per share:				
Basic EPS	$ .14	$ .14	$ .10	$ .10
Diluted EPS	$ .14	$ .14	$ .10	$ .10

	Three months ended December 31, 2003 (Unaudited)		**Three months ended September 30, 2003** (Unaudited)	
	As Reported	**As Restated**	**As Reported**	**As Restated**
Revenues	$ 599,088	$ 604,780	$ 566,461	$ 568,853
Costs and expenses	515,659	522,419	497,515	498,910

Gross profits	83,429	82,361	68,946	69,943
Gains and impairment (losses) on dispositions, net	43,953	43,690	(1,452)	524
Operating income	52,451	51,120	14,719	17,692
(Loss) income from continuing operations before income taxes	28,747	27,416	(8,722)	(5,749)
Benefit for income taxes	(1,149)	(1,650)	(3,331)	(2,209)
Net income (loss)	$ 30,420	$ 29,590	$ (4,732)	$ (2,881)
Earnings (loss) per share:				
Basic EPS	$ .10	$ .10	$ (.02)	$ (.01)
Diluted EPS	$ .10	$ .10	$ (.02)	$ (.01)

Table of Contents

	Three months ended June 30, 2003 (Unaudited)		Three months ended March 31, 2003 (Unaudited)	
	As Reported	**As Restated**	**As Reported**	**As Restated**
Revenues	$ 584,050	$ 584,553	$ 578,826	$ 579,876
Costs and expenses	489,418	489,839	463,868	465,335
Gross profits	94,632	94,714	114,958	114,541
Gains and impairment (losses) on dispositions, net	(2,469)	(3,884)	9,334	9,397
Operating income	54,171	52,838	102,881	102,527
Income from continuing operations before income taxes and cumulative effects of accounting changes	21,082	19,749	70,112	69,758
Provision for income taxes	7,008	6,494	26,138	26,003
Net income	$ 15,308	$ 14,489	$ 44,086	$ 43,867
Earnings per share:				
Basic EPS	$ .05	$ .05	$ .15	$ .15
Diluted EPS	$ .05	$ .05	$ .14	$ .14

Table of Contents

Our Company

At December 31, 2004, Service Corporation International (SCI or the Company) operated 1,216 funeral service locations and 400 cemeteries. We also had a 25% minority interest equity investment in our former funeral operations in France. In addition to our funeral and cemetery operations, we own Kenyon International Emergency Services (Kenyon), a company that engages in mass fatality and emergency response services.

Our funeral and cemetery operations are organized into a North American division covering the United States and Canada, a European division primarily consisting of operations in France and Germany, and an Other Foreign division including operations in South America and Singapore. At December 31, 2004, we also owned businesses in Argentina and Uruguay that were classified as discontinued operations. In February 2005, we sold our businesses in Argentina and Uruguay. See note twenty-one to the financial statements in Item 8 of this amended Form 10-K/A.

For the year ended December 31, 2004, our North American funeral and cemetery operations represented 90.8% of our consolidated revenues and 93.8% of our consolidated gross profits. At December 31, 2004, we owned and operated 1,190 funeral service locations and 390 cemeteries in North America.

Our operations in North America are organized into 32 major markets and 42 middle markets. Major markets are characterized by areas with large populations such as Houston, New York, and Chicago. Middle markets have relatively smaller populations and include areas such as Southern Louisiana; Memphis, Tennessee; and Lynchburg, Virginia. Each major and middle market is led by a market director with responsibility for funeral and cemetery operations as well as preneed sales. Within each market, the funeral homes and cemeteries realize efficiencies by sharing common resources such as personnel, preparation services and vehicles.

There are three market support centers in North America to assist major and middle market directors with financial, administrative and human resource needs. These support centers are located in Houston, New York and Los Angeles. The market support centers help facilitate the execution of corporate strategies, coordinate communications between the field and corporate offices and serve as liaisons for implementation of policies and procedures.

Our Competitive Strengths

Industry leader. SCI is the leading provider of funeral, cremation and cemetery services in North America. There are six other major publicly-traded companies that operate in our industry in North America (Alderwoods Group, Stewart Enterprises, Arbor Memorial Services, Carriage Services, StoneMor Group, and Keystone North America). Our revenues in North America are more than twice the size of our next largest competitor (Alderwoods Group) and are approximately equal to the combined revenues of these six other public companies. Despite some consolidation, the industry remains fragmented. We estimate that the public companies mentioned above and SCI combined generate approximately 20% of total industry revenue in North America. The other 80% is generated by independent funeral and cemetery operators.

Geographically diverse network. We operate businesses in North America in 44 states and seven Canadian provinces. We believe we are able to provide funeral services to more than 70% of the households in the United States. We believe this comprehensive national coverage enables us to be the only company in our industry to successfully implement a national branding strategy and to develop alliances with national strategic partners. Both of these initiatives are discussed below as part of our long-term revenue growth opportunities.

National branding strategy. In 2000, we launched the first national branding strategy in the funeral service industry in North America under the name Dignity Memorial®. While this branding process is intended to emphasize our seamless national network of funeral service locations and cemeteries, the original names associated with acquired locations generally remain the same. The Dignity® brand name is a co-brand to the existing name of the business. Signage, advertising and promotional efforts emphasize both names. We believe that a national brand gives us a competitive advantage. This is discussed as part of our long-term revenue growth opportunities described below.

Favorable demographics over the long term. The population is aging at an unprecedented rate. According to the U.S. Census Bureau, the number of persons 65 years or older totaled 36 million in 2003. They represented 12.3% of the population, or about one in every eight Americans. The number of Americans aged 65 and older is expected to climb to approximately 16% of the total population by 2020, and to approximately 20% by 2030. Approximately 75% of all deaths in the United States are at ages 65 and older. We believe these demographic trends will provide a growing demand in the future for our services on both an atneed and preneed basis.

Stable revenues and cash flows. Our core business can be described as stable, with relatively predictable revenue and cash flows on an annual basis. We believe our ability to consistently generate strong cash flows sets us apart from others in the industry. This stability is enhanced by a large backlog of future revenues associated with preneed funeral and cemetery sales. In North America, our backlog of preneed funeral and cemetery sales consists of more than $5 billion of revenues that will be recognized in future periods. These unfulfilled preneed funeral and cemetery contracts are primarily supported by investments in trust funds or third party insurance policies.

Financial flexibility. We believe we have significant opportunities to grow shareholder value due to our strong cash flows and liquidity, and modest debt maturities in the near term. For a further discussion about our financial flexibility, please see Financial Condition, Liquidity and Capital Resources in Item 7 of this Form 10-K/A (Amendment No. 2).

Business Challenges

No meaningful near-term increase in the numbers of deaths. The numbers of deaths in the United States are not expected to increase meaningfully in the near term. Modern advances in medicine and healthier lifestyles are contributing to record levels of life expectancy in the United States. In 2003, life expectancy in the United States reached 77.6 years according to the Centers for Disease Control and Prevention. The Baby Boom generation is expected to have an impact on the numbers of deaths in the future; however, the first Baby Boomers do not reach age 65 until the year 2011.

Increasing trend toward cremation. In North America, social trends, (such as a mobile, less rooted society), religious changes, environmental issues and cultural preferences are driving an increasing preference for cremation. Cremation rates in the United States have grown from approximately 3.6% in 1960 to approximately 28.6% in 2003 according to the Cremation Association of North America. Cremation rates in Canada during this same period have grown from approximately 3.3% to approximately 47.3%. SCI is the largest provider of cremation services in North America where approximately 40% of the total funeral services we perform are cremation services. Our cremation mix is greater than the national average due to the high concentration of properties we own in high cremation states including California, Florida, and Arizona where cremation rates exceed 47%.

The mix of cremation in our business has been increasing approximately 100 to 150 basis points each year and we expect this trend to continue in the near term. Cremation services historically have generated less revenue and gross profit dollars than traditional funeral services that involve burials. Additionally, the cremation consumer may choose not to purchase cemetery property or merchandise. Industry research has shown that most consumers choose cremation for reasons other than cost, which we believe provides us significant opportunities to better serve the cremation consumer. We believe we are well positioned to respond to this trend and have experienced initial success through the use of contemporary marketing strategies and unique product and service offerings that specifically appeal to cremation consumers. See a further discussion regarding initiatives to address cremation as part of our long-term revenue growth opportunities described below.

Increasing competition from low cost retailers. In recent years there has been an influx of retail outlets and internet websites specializing in the sale of funeral and cemetery products, particularly caskets, vaults and markers. While these types of businesses have grown in numbers and have caused pricing pressure in certain markets, we do not believe they are having a material impact on our consolidated financial results at this time. As we continue to develop strategies that are centered on creating a meaningful experience for the consumer with a greater focus on innovative service offerings and less emphasis on traditional product offerings, we expect the influence of these types of businesses will be even less.

Regulatory and litigation exposure. Our industry is heavily regulated at the federal and state levels. Although we believe we are in compliance in all material respects with these regulations, there is a continuous movement toward a stricter regulatory environment. Our compliance department strives to keep our businesses up-to-date on changes in regulation and to develop programs to monitor our compliance with various regulations. From time-to-time, we are also exposed to matters that result in litigation. We work diligently to investigate and resolve such litigation as quickly and thoroughly as possible and have placed a great deal of focus throughout the Company on litigation avoidance practices and programs. Lastly, as a public company, compliance with regulations such as the Sarbanes-Oxley Act has become increasingly costly and time-consuming for our company.

The Path to Growth

We have made substantial progress in reducing debt and improving cash flow since 1999. Our current capital structure and liquidity afford us significant financial flexibility. Our primary focus is now on initiatives that will grow revenues and earnings. We believe strategies centered on our national brand, Dignity Memorial®, and other revenue growth initiatives, along with a focus on cost management, can provide the framework for sustainable growth over the longer term.

Improving the Infrastructure

Historically, our infrastructure did not allow us to fully realize the inherent efficiencies of our business organization. As a result, we were unable to capitalize on all of the benefits of standardization, technology, and process improvement. Beginning in late 2002 and continuing through 2003, we moved to capture more fully the inherent economies of scale of our business by reformulating our infrastructure. This has been accomplished by redesigning our sales organization, improving business and financial processes, outsourcing certain of our accounting functions including accounts payable and payroll, and expanding our existing trust administration and information technology outsourcing programs. In 2003 and continuing through 2004, we also implemented a new information system in our field locations. This new system replaced three separate contract entry systems and integrated these functions into one. At December 31, 2004, the new information system is fully implemented and functioning as intended.

Having simplified our sales approach and redesigned our financial, technical and administrative infrastructure, we were able to make significant changes to the field management structure in late 2003. The former management structure consisted of multiple layers and two organizations (sales and operations). The new management structure is based on a major market and middle market concept with the understanding that our markets and businesses are not all the same and can benefit from different management approaches. We eliminated the dual management organizational structure, and now have one person responsible for each market who has the ability to lead in a multi-segment environment. This individual is charged with the responsibility of growing our business and maintaining a commitment to the Dignity Memorial® standards and brand.

Building the Brand

SCI has implemented the first national brand in the funeral service industry. This brand is called Dignity Memorial®. We believe that a national brand name will provide us access to new customers over the long term given the increasingly mobile nature of families in North America. We believe consumers are less likely to know a funeral director personally or live in the same area as past generations who may have used funeral home services before. A favorable experience with Dignity Memorial® through one of our national advertising or community outreach programs, attending a funeral service at a Dignity® location, or through previous use of a Dignity® provider may influence a consumer to choose one of our funeral homes.

Internally, we are focused on ensuring that we have consistency in service standards and processes across our network of businesses. We want every customer interaction to be the standard Dignity interaction, which is based upon values of integrity, respect, enduring relationships and service excellence.

Externally, we continue to enhance signage and local advertising efforts using the Dignity® name and logo. Through our national brand we are also the sponsor of several nationally recognized community programs including Dignity Memorial Escape School® (www.escapeschool.com), which provides parents and their children with critical abduction prevention and escape techniques; Dignity Memorial Smart and Safe Seniors (www.smartandsafe.com), which educates seniors about consumer fraud, cons and scams, travel safety and other topics; and The Vietnam Wall Experience (www.vietnamwallexperience.com), a traveling, three-quarter sized replica of the Vietnam Veterans Memorial in Washington, D.C.

19

In 2004, we rolled out a marketing campaign to promote awareness of our national brand name throughout North America. The campaign focused on the distinct benefits and values that set Dignity Memorial® apart from other providers. The marketing approach utilized response driven communications executed through television, print, radio, direct mail, point of purchase collateral materials, the internet and yellow pages. Those requesting additional information are directed to a local Dignity® provider. In 2004, the campaign reached 113 designated market areas, or more than 80% of all households in the United States, according to Nielsen Media Research.

Growing Our Revenues

We have made significant improvements to our cost structure in the last two years; however, we realize that to achieve sustainable long-term earnings growth, we must also increase our revenues. We believe we can be successful in this regard by developing the Dignity® brand and focusing on our customers concerns and satisfaction.

The world of funeral service is changing. As aging Baby Boomers begin to contemplate and deal with the realities of death, they bring with them new attitudes, ideas, requirements and preferences when it comes to observing the final stage of life. Traditional rituals associated with funerals are transitioning to new and modern ways to personalize and create a meaningful experience.

Through our Dignity® brand we are developing more contemporary and comprehensive products and services that we believe will help the consumer create a personal experience as well as help them with the administrative and legal challenges that occur when a loved one dies. Some of the exclusive items offered through Dignity® providers include grief counseling services offered 24-hours a day, 365 days a year; a legal services membership; and internet memorial archive capabilities through Making Everlasting Memories®, or MeM® (www.mem.com). MeM® publishes written biographies, photos, memories and tributes shared by loved ones around the world that capture the essence of one s life. A product that is particularly helpful to our consumers is the Aftercare® Planner a comprehensive organization system that helps families manage the many business details that arise after a death occurs. Dignity® benefits also include the Bereavement Travel Program, a unique feature that allows customers to obtain special rates on airfare, car rentals and hotel accommodations for family and friends who travel from out of town to attend funeral, cremation or memorial services. Importantly, these products and services appeal to both burial and cremation consumers.

We are also focused on offering consumers new ways to personalize funeral services and create value in the experience. Examples include creating movies from pictures that span the person s life and important events; displaying items that were special to the individual or that reflect a hobby; having a dove, butterfly or balloon release; or holding a memorial service in a favorite place such as a park, marina or sports venue.

Near-Term Revenue Growth Opportunities

Dignity® packaged plans. Our national brand name represents a unique set of packaged funeral and cremation plans offered exclusively through our network on an atneed and preneed basis. These packages are designed to simplify customer decision-making and include the unique value-added products and services described above that have traditionally been unavailable through funeral service locations. The plans also offer the security of a 100% service guarantee and national transferability of preneed services to any of more than 1,300 Dignity Memorial® providers in North America. In 2004, we continued to achieve high customer satisfaction ratings, as measured by independent surveys completed by consumers three weeks following a funeral. We believe this is largely attributable to the value consumers receive when they select a Dignity® package. When Dignity® packages are sold, it results in significant incremental revenue and gross profit margin per funeral service compared to non-Dignity sales due to the comprehensive product and service offerings they provide.

In early 2005, we began to develop Dignity Memorial® packaged cemetery plans. These plans are being tested in a limited number of locations. After completing a successful test, we intend to begin the roll-out of this packaged plan initiative to our cemeteries in mid-2005.

Contemporary funeral merchandising strategies. In 2004, approximately 17% of the total funeral consumers we served selected a Dignity® packaged plan. On a preneed basis, approximately 24% of funeral preneed contracts sold were Dignity® plans. We believe we can increase the selection rate of the Dignity® packaged plans through improved merchandising strategies that place less emphasis on traditional funeral merchandise and more focus on the comprehensive product and service offerings unique to Dignity Memorial® providers. In late 2004, we began to roll-out enhanced merchandise displays and other presentation models in our funeral homes that offer personalization options. In addition, funeral personnel at each of these locations have completed a comprehensive training and certification program to ensure their effectiveness and optimal customer satisfaction.

Contemporary cemetery marketing strategies. We are beginning to use more contemporary marketing techniques within our cemetery segment. We have begun to employ a tiered-product model that emphasizes a wide range of product and service offerings, including a variety of grave spaces at various price levels, cremation gardens, mausoleums, lawn crypts and niches. We are particularly focused on the development of high-end cemetery property such as private family estates.

Table of Contents

In late 2004, we also developed and began to implement a standardized pricing methodology for each of our cemeteries. This approach incorporates marketplace demographic information and data about competitive cemeteries in the market, as well as historical retail and wholesale prices. This new pricing methodology complements our tiered-product strategy and ensures that we are capturing appropriate values for the different levels of our products.

Improved management structure. In late 2003, we eliminated the dual management structures of sales and operations and replaced them with a single-line business management structure. In addition to reducing costs, this new structure is intended to have our strongest business managers focused on producing favorable financial results in each of our markets. Under the old structure, multiple persons shared accountability and responsibility for financial results in multiple markets. Now accountability rests solely in the market director in charge of the geographical area that he or she manages. Under the new structure, many of the administrative and financial functions are now handled by market support centers. We believe this new structure allows for greater focus on developing people, growing market share, and improving profitability.

Preneed sales. At December 31, 2004, the backlog of revenues associated with unfulfilled preneed contracts sold for funeral and cemetery merchandise and services in North America totaled more than $5 billion. We believe that the sale of preneed goods and services is a primary driver of maintaining and growing market share. It also provides a level of predictability and stability to our revenues and cash flows. Over the last two years, we have redesigned our sales organization to tailor our approach to emerging customer preferences, to reduce costs, and to increase our effectiveness. We eliminated certain lead generation programs and incentive travel programs and moved to an approach that is based on personal referrals and standardized professional certification. We also shifted from a compensation model that was solely based on commissions to one where sales counselors can receive a portion of sales compensation through a draw with the opportunity to earn a bonus if certain sales targets are achieved. We are continuing to invest in our sales organization in 2005 through continued training and certification programs.

An important advantage of SCI preneed sales for consumers, besides protecting them from having to make important decisions at a difficult time and locking in prices at today s level, is the ability to transfer preneed contracts to funeral homes and cemeteries throughout our geographically diverse network of properties.

Long-Term Revenue Growth Opportunities

Enhancing cremation opportunities. To grow core revenues and profits, we believe we must capitalize on the opportunities provided by the growing cremation trend. We believe a successful cremation strategy is built on product differentiation, personalization and simplicity. Along with the sale of Dignity Memorial® cremation plans, we are developing new displays to be used in the arrangement process that clearly explain the products and services available to cremation consumers. We also own and operate National Cremation®, which specifically targets the cremation consumer. Within the cemetery segment, we are promoting cremation gardens, which are separate sections located within certain of our cemeteries where cremated remains can be permanently placed and that contain other unique memorialization products.

Developing access to new customers. We believe that SCI has opportunities to grow market share due to its size and geographic diversity. As discussed earlier, we believe that a national brand name will provide us access to new customers over the long term.

Our centralized marketing effort will utilize information from our broad customer databases to identify geographic, demographic and lifestyle information about our consumers in order to promote awareness of the Dignity Memorial® brand name, our local names and our provider network in the most efficient and effective manner.

In addition, we will continue to capitalize on our nationwide network of providers to develop affinity relationships with large groups of individuals to whom we can market our products and services. Such relationships include employers, social organizations and insurance companies. Our most strategic affinity partnership today is with the Veterans of Foreign Wars and Ladies Auxiliary whose membership exceeds two million. Over the longer term, we believe such groups can be a key influence in the funeral home selection process.

We continue to develop marketing strategies that target specific ethnic groups. As an example, we are developing a brand of businesses that specifically appeal to the Hispanic population. This brand is called Funeraria del ángel (Funeral Home of the Angel). According to the United States Census Bureau, the Hispanic population reached 39.9 million in 2003, accounting for about one-half of the 9.4 million residents added to the nation s population since

Census 2000. We currently operate Funeraria del ángel in 12 California locations, three Chicago locations and six affiliated locations in Miami.

Expanding through acquisition, construction, or franchise. We are also targeting expansion through acquisition or construction in the top 150 markets in North America where probable investment returns will exceed our cost of capital. We will focus future growth capital deployment in the major metropolitan markets where there is a large population base. In areas with large populations, the businesses are more institutional and less dependent on an individual; it is more conducive to have multiple businesses and realize economies of scale through clustering; we can benefit more from using contemporary marketing strategies; and it is easier to attract quality management. In states where allowed, we intend to focus construction efforts on developing more combination operations by building funeral homes on our existing cemeteries. Combination operations create synergies between funeral and cemetery functions and provide consumers the convenience of making all arrangements at a single location.

Over the longer term, the potential for a franchising opportunity exists for further expansion in the smaller markets. In a franchise relationship we could recruit independent funeral providers to join the Dignity Memorial® network and earn fees for a comprehensive range of services that we could provide to the franchisee all at very little or no capital cost to us.

Developing our people. A key objective that we believe will have a favorable impact on our future growth and success is building a best in class workforce. We have developed a comprehensive education strategy in an online campus format called Dignity University . Dignity University features job-focused curriculum for each position in the company. Upon completion of coursework, participants are required to pass examinations to be certified in their individual jobs. Dignity University uses a blended approach to learning using a combination of traditional classroom, web-based courses, virtual classroom and on-the-job training for the approximately 20,000 individuals that we employ in North America.

In conjunction with Dignity University , we use an online performance management tool that employees use to document their annual key objectives. Objectives are balanced between financial, operations, customer/market, and leadership/employee development. These objectives are then weighted by management and linked to incentive compensation. During the year, managers monitor and provide regular feedback on progress towards these objectives. Training and development courses are assigned as needed.

Focusing on customer loyalty. We began to track customer satisfaction in our funeral segment in 2000 through the use of independent surveys mailed to every consumer three weeks following the funeral. On average, we receive more than 40% of the surveys back. Through statistically weighted questions, we are able to track satisfaction scores at the funeral home, region, and company levels. Results are used to share best practices and develop training programs in areas where weaknesses are identified. During 2004, over 98% of the respondents in North America indicated that they were likely to recommend our services.

In 2005, we moved to a new program with J.D. Power and Associates, one of the world s premier marketing firms specializing in customer satisfaction. Our new survey to client families utilizes a combined approach measuring satisfaction and loyalty and the relationship between the two. The new survey will be used for both funeral and cemetery consumers and will be available in three different languages. After completing a successful test of the new measurement tool, the new survey was launched on a national basis in March 2005.

Becoming the preplanning experts. As the Baby Boom generation ages, many are becoming more aware of their own mortality or facing their parents approaching need for funeral and burial arrangements. While research indicates high public approval of the pre-planning concept, the percentage of North Americans who have actually completed such arrangements is quite small.

Historically we have focused on preplanning and prefunding funeral arrangements. Our focus for the long-term is developing a comprehensive marketing strategy to give consumers the opportunity to make the decisions about their funeral and to choose a Dignity Memorial® funeral provider without paying in advance if they choose not to do so. Based on research and testing with members of the Veterans of Foreign Wars in seminars conducted in 2003 and 2004, we have found initial success in creating a commitment pattern on behalf of the consumer without funding.

Critical Accounting Policies, New Accounting Pronouncements and Accounting Changes

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

Revenue Recognition

Funeral revenue is recognized when funeral services are performed. Our trade receivables primarily consist of amounts due for funeral services already performed. We sell price guaranteed preneed funeral contracts through various programs providing for future funeral services at prices prevailing when the agreements are signed. Revenues associated with sales of preneed funeral contracts, including accumulated trust earnings, are deferred until such time that the funeral services are performed (see notes three, four, and five to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2).

Revenue associated with cemetery merchandise and services is recognized when the service is performed or merchandise is delivered. Revenue associated with cemetery property interment rights is recognized in accordance with the retail land sales provision of SFAS No. 66, *Accounting for the Sales of Real Estate* (SFAS 66). Under SFAS 66, revenue from constructed cemetery property is not recognized until a minimum percentage (10%) of the sales price has been collected. Revenue related to the preneed sale of unconstructed cemetery property is deferred until it is constructed and 10% of the sales price is collected. Revenue associated with sales of preneed merchandise and services is not recognized until the merchandise is delivered or the services are performed (see notes three, four, and six to the consolidated financial statements in Item 8 of this 10-K/A (Amendment No. 2).

Impairment or Disposal of Long-Lived Assets

We test for impairment of goodwill using a two-step approach as prescribed in SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The first step of our goodwill impairment test compares the fair value of a reporting unit with its carrying amount, including goodwill. We do not record an impairment of goodwill in instances where the fair value of a reporting unit exceeds its carrying amount. The second step of our goodwill impairment test is required only in situations where the carrying amount of the reporting unit exceeds its fair value as determined in the first step. In such instances, we compare the implied fair value of goodwill (as defined in SFAS 142) to its carrying amount of goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Fair market value of a reporting until is determined using a calculation based on multiples of revenue and multiples of EBITDA of both SCI and its competitors. Based on our tests at September 30, 2004 and September 30, 2003, we concluded that there was no impairment of goodwill in accordance with SFAS 142.

We apply SFAS No. 60 *Accounting and Reporting by Insurance Enterprises* (SFAS 60) to test for impairment of our deferred selling costs as prescribed by the AICPA Industry Guide, *Life and Health Insurance Entities* . Accordingly, when circumstances indicate that actual experience for a portfolio of contracts, regardless of the year of origin, may result in losses, we assess whether the expected gross contract revenues for each portfolio of preneed funeral contracts or preneed cemetery contracts less all related expected contract costs is sufficient to cover the current unamortized deferred selling costs associated with each portfolio. For purposes of applying this policy, a portfolio of preneed funeral contracts or preneed cemetery contracts is comprised of all such contracts executed within a given market (i.e. an area of operation). If deferred selling costs for a portfolio of contracts exceeds the related gross contract revenue less expected contract costs, the excess is charged to expense. We believe this is the most appropriate way to evaluate impairment because it is consistent with the manner in which we acquire, service, and measure the profitability of our preneed funeral and cemetery contracts. Our sales organization is organized by market, and the selling costs incurred and deferred specifically relate to the preneed funeral and cemetery deferred revenues recorded in the operating market. The Company is addressing loss contracts in its impairment review of deferred selling costs because we are including all related expected costs in the contract analysis. The application of the requirements under SFAS No. 5 Accounting for Contingencies is comparable with the Company s current application of the requirements under SFAS 60. In 2004, the Company performed an impairment test for cemetery and funeral deferred selling costs with no impairment indicated.

We do not track cash flow at the individual contract level as defined by SFAS No. 144 for preneed funeral and cemetery contracts. Further, we do not believe that evaluation for impairment at the individual contract level is required by SFAS 60 or SFAS 5. We believe the lowest level of identifiable cash flows associated with our preneed funeral and cemetery activities is at our market level of operations. The contracts are homogenous at this level. Therefore, the assumptions at this level would be the same as on an individual contract level.

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

Use of Estimates

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

Allowances We provide various allowances and/or cancellation reserves for our funeral and cemetery preneed and at need receivables, our preneed funeral and preneed cemetery deferred revenues, as well as for our funeral and cemetery deferred selling costs. These allowances are based on an analysis of historical trends and include, where applicable, collection and cancellation activity. These estimates are impacted by a number of factors, including changes in economy, relocation, and demographic or competitive changes in our areas of operation.

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

Depreciation of long-lived assets We depreciate our long-lived assets over their estimated useful lives. These estimates of useful lives may be affected by such factors as changing market conditions or changes in regulatory requirements. In 2002, we changed the estimated useful life of our existing information technology systems as a result of the decision to implement a new North America point of sale system and an upgraded general ledger system. We recognized approximately $13.8 million of additional amortization expense related to this change in estimate in 2003 and did not recognize any additional amortization expense in 2004 as the system was fully amortized in 2003.

Deferred selling costs Our policy is to defer selling costs that vary with and are primarily related to the acquisition of preneed funeral (trust funded only) and preneed cemetery contracts, and to expense such costs in proportion to the revenue recognized. This deferral, which is calculated based on deferral rates discussed below, and amortization model follows the provisions of SFAS 60, *Accounting and Reporting by Insurance Enterprises* (SFAS 60). The selling costs subject to deferral are the pool of compensation expense and related fringe costs incurred by our sales counselors and sales managers. Other selling costs associated with the sales and marketing of preneed funeral and cemetery contracts (e.g., lead procurement costs, brochures and marketing materials, advertising and general administrative costs) are expensed as incurred.

Deferral rates are determined for the following:

- Preneed funeral contracts
- Preneed cemetery contract items:
  - Interment rights (burial property)
  - Merchandise
  - Services

These deferral rates are based on the ratio of the selling compensation and fringe costs to preneed funeral and cemetery production (in dollars) weighted accordingly in the manner for which the counselor is compensated (with interment rights, or burial property, being the highest and preneed cemetery services being the lowest compensation to the counselor). In developing the deferral rates, we review various rate scenarios to ensure the finalized rates, when applied to forecasted production dollars, are reasonable compared to forecasted selling compensation. Additionally, the developed deferral rates are reviewed annually for reasonableness compared to current and historical commission rates used by the Company.

As preneed funeral and cemetery contracts are processed, the rates are applied systematically to the production dollars and the resulting amount is deferred. As a result, the funeral and cemetery deferred selling costs are only generated when preneed funeral and cemetery contract production is recorded. Therefore, these deferred selling costs vary with and relate primarily to the production of the business. We have separate deferred selling cost accounts related to preneed funeral, preneed cemetery interment rights, preneed cemetery merchandise, and preneed cemetery services. The deferred preneed funeral and cemetery revenue accounts are recorded similarly.

Periodically, the selling costs deferred are compared to the actual costs incurred to ensure there is not a significant variance between the two.

The deferred selling costs are expensed in proportion to the revenue when recognized (proportionate method). This is determined annually by the ratio of the unamortized deferred selling costs (funeral, cemetery interment rights, cemetery merchandise and cemetery services) to the associated deferred revenue, and systematically applying this ratio against the deferred selling cost accounts as the applicable revenues are recognized.

Table of Contents

We do not attribute deferred selling costs to each individual contract (or each item in the case of cemetery deferred selling costs) because our systems do not currently have the complete functionality to defer and amortize the costs and we have no other cost effective means by which to do so. We believe using the proportionate method of amortization and the homogenous nature of the 430,000 preneed funeral contracts and 3.6 million of preneed cemetery contract items (as separated by interment rights, merchandise and services) allow for a systematic match of costs with related revenues.

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

Pension cost Our pension costs and liabilities are actuarially determined based on certain assumptions, including expected long-term rates of return on plan assets and the discount rate used to compute future benefit obligations. In 2003 and prior years, it was our policy to use a discount rate for return on assets comparable to rates of return on high-quality fixed income investments available and expected to be available during the period to maturity of the Company s pension benefits. Actuarial gains and losses resulting from changes in the assumptions, or experience differences from those assumptions, were amortized over the remaining service period of active employees expected to receive benefits under the plans. In 2004, we changed our method of accounting for gains and losses on pension assets and obligations to recognize such gains and losses in our consolidated statement of operations during the year in which they occur. We recorded net pension expense reflecting estimated returns on plan assets and obligations for our interim financial statements. Under the new accounting policy, upon the review of our annual remeasurement, we recognized actual gains and losses on plan assets and obligations. See notes four and sixteen to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2) for more information related to pensions.

We used a 9.0% assumed rate of return on plan assets in 2003 as a result of a high allocation of equity securities within the plan assets. In 2004, the rate of return on plan assets is not applicable as we recognize gains and losses on plan assets during the year in which they occur. At December 31, 2004, 55% of the plan assets were invested in core diversified and market neutral hedge funds, 33% of the plan assets were equity securities and the remaining 12% of plan assets were fixed income securities. As of December 31, 2004, the equity securities were invested approximately 57% in U.S. Large Cap investments, 22% in international equities and 21% in U.S. Small Cap investments.

In connection with the $20 million infusion of funds into the plan in early 2004, we rebalanced the plan assets to have a lower percentage invested in traditional equity securities and fixed income securities and instead incorporate investments in hedge funds. We believe that over time this reallocation will reduce the volatility with limited reduction of returns.

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

Our independent actuaries used five actuarial methods generally accepted by the Casualty Actuarial Society to arrive at an estimate of a range that we refer to as reasonably possible . The Actuarial Standard of Practice No. 36 (ASOP 36 published by the American Academy of Actuaries) states: A range of reasonable estimates is a range of estimates that could be produced by appropriate actuarial methods or alternative sets of assumptions that the actuary judges to be reasonable. Methods used to determine the Company s reasonably possible range are: paid and incurred loss development methods; frequency-severity methods; and paid and incurred Bornhuetter-Ferguson methods. All of these methods were used to determine our reasonably possible range of insurance loss reserves for the years ended December 31, 2004, 2003 and 2002.

We have not changed our methodologies for determining the reasonably possible range; however, there are changes made to the assumptions as the loss development factors are updated. These loss development factors are determined based on our historical loss development data[1] and are updated annually as new data becomes available. As a result, the loss development factors used in the

Table of Contents

December 31, 2004 analysis could be different from the loss development factors used in the December 31, 2005 analysis. We consider these changes in loss development factors synonymous to changes in assumptions . The final loss estimate is not determined by weighting the methodologies, but instead is subjectively arrived at by our independent actuary considering the relative merits of the various methods and the truncated average of the various methods.

For each loss type (workers compensation, general liability, and auto liability) loss triangles are generated, which show the cumulative valuation of each loss period over time. The loss components evaluated include incurred losses, paid losses, reported claim counts, and average incurred loss. The actuarial analysis of losses uses this data to estimate future loss development or settlement value of the losses. Since these loss development factors are an estimate about future loss development, the calculation of ultimate losses is also an estimate. The actual ultimate loss value may not be known for many years, and may differ significantly from the estimated value of the ultimate losses.

As of December 31, 2004, reported losses within our retention for workers compensation, general liability and auto liability incurred during the period May 1, 1987 through December 31, 2004 were approximately $188.1 million. The selected fully developed ultimate settlement value estimated by our independent actuary was $222.5 million. Paid losses were $175.9 million indicating a reserve requirement of $46.7 million. After considering matters discussed with our independent actuary related to this calculation, we estimated the reserve to be $47.3 million as of December 31, 2004.

At December 31, 2004 and 2003, the balances in the reserve and the related activity were as follows:

(Dollars in millions)	
Balance at December 31, 2002	$ (39.0)
Additions	(31.6)
Payments	23.8
Balance at December 31, 2003	$ (46.8)
Additions	(38.3)
Payments	37.8
Balance at December 31, 2004	$ (47.3)

Our independent actuary performed a sensitivity analysis that was modeled to assess the impact of changes to the reserve pertaining to workers compensation, general liability, and auto liability. The sensitivity analysis assumes an instantaneous 5% adverse change to the loss development factors as summarized below.

(Dollars in millions)	**Sensitivity Analysis**
Workers Compensation	$ 1.30
General Liability	$ 0.82
Auto Liability	$ .24
Total Sensitivity	$ 2.36

(1) The loss development factors used in the December 31, 2004 calculation

are based on the Company s actual claim history by policy year for the period beginning May 1, 1991 May 1, 2004.

New Accounting Pronouncements and Accounting Changes

Other Than Temporary Impairments

In March 2004, the Financial Accounting Standards Board (FASB) reached consensus on the guidance provided by Emerging Issues Task Force Issue 03-1 (EITF 03-1), *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. The guidance is applicable to debt and equity securities that are within the scope of FASB Statement of Financial Accounting Standard (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. EITF 03-1 specifies that an impairment would be considered other-than-temporary unless (a) the investor has the ability and intent to hold an investment for a reasonable period of time sufficient for the recovery of the fair value up to (or beyond) the cost of the investment and (b) evidence indicating the cost of the investment is recoverable within a reasonable period of time outweighs evidence to the contrary. EITF 03-1 was scheduled to be effective for reporting periods ending after June 15, 2004. The measurement and recognition provisions relating to debt and equity securities have been delayed until the FASB issues additional guidance. We adopted the disclosure provisions of EITF 03-1 during the period ended June 30, 2004. The adoption of the measurement and recognition provisions are not expected to have a material impact on our consolidated financial statements, results of operations, financial position, or cash flows.

Inventory Costs

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs an amendment of ARB 43, Chapter 4* (SFAS 151). SFAS 151 amends the guidance in ARB No. 43, Chapter 4, *Inventory Pricing,* to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. SFAS 151 requires that those items be recognized as current-period charges, rather than as a portion of the inventory cost. In addition, SFAS 151 requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not expect this statement to have a material impact on our consolidated financial statements, results of operations, or cash flows.

Income Taxes

In December 2004, the FASB issued Staff Position No. FAS 109-1 *Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities provided by the American Jobs Creation Act of 2004* (FAS 109-1). The American Jobs Creation Act of 2004, enacted on October 22, 2004, provides for a deduction for certain qualified production activities. FAS 109-1 provides guidance for the application of FASB Statement No. 109, *Accounting for Income Taxes*, to the deduction for certain qualified production activities, and was effective immediately upon issuance. We do not believe that the adoption of FAS 109-1 will have a significant effect, if any, on our consolidated financial statements, results of operations, or cash flows.

In December 2004, the FASB issued Staff Position No. FAS 109-2 *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* (FAS 109-2). The American Jobs Creation Act of 2004 (Jobs Act), enacted on October 22, 2004, provides for a temporary 85% dividends-received deduction on certain foreign earnings repatriated to a U.S. taxpayer, provided certain criteria are met. FAS 109-2 provides accounting and disclosure guidance for the repatriation provision, and was effective immediately upon issuance. We are in the process of evaluating whether we will repatriate earnings under the repatriation provisions of the Jobs Act, and if so, the amount that will be repatriated; therefore, as provided for in FAS 109-2, deferred tax liabilities have not been adjusted. We estimate the range of possible amounts of unremitted earnings under consideration is between $0 and $2.3 million. If the maximum amount of $2.3 million were to be repatriated, we would accrue tax expense of approximately $0.4 million.

Share-Based Payment

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

We currently utilize a standard option pricing model (i.e., Black-Scholes) to measure the fair value of stock options granted to employees. While SFAS 123R permits entities to continue to use such a model, the standard also permits the use of a lattice model. We performed a cost-benefit analysis comparing option pricing models. Based on this analysis, we will continue to utilize the Black-Scholes option pricing model to measure the fair value of our stock options.

We expect to adopt SFAS 123R effective July 1, 2005. We are currently evaluating the impact that this adoption will have on our results of operations. See note fifteen to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2) for further information related to our stock-based compensation plans.

Variable Interest Entities

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

Interpretation No. 46 (FIN 46R).

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

Consolidation of Trusts: We implemented FIN 46R as of March 31, 2004, which resulted in the consolidation of our preneed funeral and cemetery merchandise and service trust assets and our cemetery perpetual care trusts. No cumulative effect of an accounting change was recognized as a result of the implementation of FIN 46R as it relates to the consolidation of the trusts. The implementation of FIN 46R affects certain line items on our consolidated balance sheet and statement of operations as described below; however, there is no impact to net income in the statement of operations as a result of the implementation. Additionally, the implementation of FIN 46R did not result in any net changes to our consolidated statement of cash flows; however, it does require certain financing and investing activities to be disclosed. For additional information, see notes five through eight to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2).

Although FIN 46R requires consolidation of most of the merchandise and service and perpetual care trusts, it does not change the legal relationships among the trusts, SCI and our customers. In the case of merchandise and service trusts, the customers are the legal beneficiaries. In the case of cemetery perpetual care trusts, we do not have a legal right to the perpetual care trust assets. For these reasons, upon consolidation of the trusts, we recognize non-controlling interests in our financial statements to reflect third party interests in these trusts in accordance with FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liability and Equity* (SFAS 150). We classify deposits to merchandise and service trusts as non-controlling liability interests and classify deposits to cemetery perpetual care trusts as non-controlling equity interests.

We record cash received from customers that is payable to the trust, but not yet required to be deposited in the trusts as restricted cash in *Deferred charges and other assets* in our consolidated balance sheet. At December 31, 2004, these pending deposits totaled $11.2 million. We continue to account for amounts received from customers prior to delivery of merchandise or services that are not required to be deposited in merchandise and service trusts as deferred revenue.

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

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

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

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

Both the merchandise and services trusts and the cemetery perpetual care trusts hold investments in marketable securities that are classified as available-for-sale under the requirements of Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115). In accordance with SFAS 115, available-for-sale securities of the trusts are recorded at fair value, with unrealized gains and losses excluded from earnings and initially recorded as a component of *Accumulated other comprehensive loss* in our consolidated balance sheet. Using the guidance in EITF Topic D-41, *Adjustments in Assets and Liabilities for Holding Gains and Losses as Related to the Implementation of FASB Statement No. 115* (Topic D-41), unrealized gains and losses on available-for-sale securities of the trusts attributable to the non-controlling interest holders are not recorded as *Accumulated other comprehensive income (loss)*, but are recorded as an adjustment to either *Non-controlling interest in funeral and cemetery trusts* or *Non-controlling interest in perpetual care trusts*. Therefore, unrealized gains and losses attributable to the non-controlling interest holders are reclassified from *Accumulated other comprehensive income (loss)* to either *Non-controlling*

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interest in funeral and cemetery trusts or *Non-controlling interest in perpetual care trusts*. The gross effect from applying Topic D-41 on our *Accumulated other comprehensive income (loss)* is disclosed in note fifteen of the consolidated financial statements in item 8 of this Form 10-K/A (Amendment No. 2). However, our *Accumulated other comprehensive income (loss)* on the face of the balance sheet is ultimately not affected by consolidation of the trusts.

For additional discussion of our accounting policies after the implementation of FIN 46R, see notes five through eight to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2).

Consolidation of Certain Cemeteries: Prior to December 31, 2003, we operated certain cemeteries that we managed but did not own. During our evaluation of FIN 46R, we evaluated these cemeteries to determine whether such cemeteries were within the scope of FIN 46R. The investment capital of these cemeteries was financed by the Company in exchange for a long-term sales, accounting, and cash management agreement. In accordance with this agreement, we received the majority of the cash flows from these cemeteries. Additionally, we absorb the majority of these cemeteries expected losses and receive a majority of the cemeteries residual returns. As a result, the Company determined itself to be the primary beneficiary of these cemeteries and determined the long-term sales, accounting, and cash management agreement to be a variable interest as defined by FIN 46R. Given the circumstances above, the Company consolidated such cemeteries at March 31, 2004. We recognized an after tax charge of $14.0 million, representing the cumulative effect of an accounting change, as a result of consolidating these cemeteries. The results of operations and cash flows of these cemeteries are included in our consolidated statements of operations and cash flows beginning March 31, 2004. Excluding the cumulative effect of accounting change, the effect of consolidating these entities did not have a significant impact on our reported results of operations.

Insurance Funded Preneed Funeral Contracts

We changed our method of accounting for insurance funded preneed contracts as we have concluded that our insurance funded preneed funeral contracts are not assets and liabilities as defined by Statement of Financial Accounting Concepts No. 6, *Elements in Financial Statements.* Therefore, we have removed from our consolidated balance sheet amounts relating to insurance funded preneed funeral contracts previously recorded in *Preneed funeral receivables and trust investments* and *Deferred preneed funeral revenues*, which at December 31, 2003, were $3.5 billion. The removal of these amounts did not have an impact on our consolidated stockholders equity, results of operations or cash flows. See note five to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2) for additional information on insurance related preneed funeral balances.

Goodwill and Other Intangible Assets

In accordance with SFAS 142, effective January 1, 2002, we recognized a charge reflected as a cumulative effect of an accounting change of $135.6 million (net of applicable taxes) or $.46 per diluted share related to the impairment of goodwill in our North America cemetery reporting unit. See note nine to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2) for additional information on goodwill.

Pension Plans

In December 2003, the FASB revised SFAS No. 132, *Employers Disclosures about Pensions and Other Postretirement Benefits* (SFAS 132R). SFAS 132R requires additional disclosures about the assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. We have adopted the revised disclosure requirements. Our pension plans are frozen with no cost benefits accreting to participants except interest.

Effective January 1, 2004, we changed our accounting for gains and losses on our pension plan assets and obligations. We now recognize such gains and losses in our consolidated statement of operations as such gains and losses are incurred under pension accounting. Prior to January 1, 2004, we amortized the difference between actual and expected investment returns and actuarial gains and losses over seven years (except to the extent that settlements with employees required earlier recognition). We believe the new method of accounting better reflects the economic nature of our pension plans and recognize gains and losses on the pension plan assets and obligations in the year the gains or losses occur. As a result of this accounting change, we recognized a charge for the cumulative effect of an accounting change of $33.6 million (net of tax) as of January 1, 2004. This amount represents accumulated unrecognized net losses related to the pension plan assets and liabilities. In addition, for interim periods, we record net pension expense or income reflecting estimated returns on plan assets and obligations. We will recognize actual gains and losses on plan assets and obligations as actuarial information becomes available upon review of the annual remeasurement. See note sixteen to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2) for additional information on pensions.

Deferred Selling Costs

We have made an accounting policy election to begin expensing these selling costs as of January 1, 2005 in the period incurred rather than deferred as this method is the preferable of the two acceptable methods. Associated with this accounting policy election, we will file a preferability letter with the Securities and Exchange Commission in connection with our Quarterly Report on Form 10-Q for the period ended March 31, 2005. We will incur a non-cash charge of approximately $312 million before tax representing the write-off of deferred selling costs recorded on our balance sheet as of January 1, 2005. Additionally, if we had expensed these selling costs in 2004 and 2003, our pretax income would have been reduced by approximately $14 million, or $.03 per diluted share and $11 million, or $.02 per diluted share, respectively. A change in the treatment of deferred preneed selling costs would have no impact on our cash position or net cash provided by operating activities.

Results of Operations Twelve Months Ended December 31, 2004, 2003 and 2002

In 2004 we restated our unaudited quarterly financial data for the first three interim periods of 2004. Additionally, we are amending this Form 10-K/A (Amendment No. 2) to restate results for the years ended 2004, 2003, and 2002. For details relating to these restatements, see notes two and twenty-two to the consolidated financial statements in Item 8 of this Form 10-K/A (Amendment No. 2).

In the following discussion of results of operations, certain prior year amounts have been reclassified to conform to the current period financial presentation with no effect on previously reported results of operations, financial position or cash flows.

Net income for fiscal 2004 was $114.1 million or $.35 per diluted share compared to net income of $85.1 million or $.28 per diluted share in the same period of 2003 and a net loss of $234.6 million or $.80 per diluted share in 2002. These results include cumulative effects of accounting changes, litigation expenses, gains and losses on dispositions, gains and losses on early extinguishments of debt, income tax benefits, earnings from discontinued operations, and other income and expenses as further described below. Additionally, our former funeral operations in France (which were sold in March 2004) contributed $.02 of earnings per share in 2004 compared to $.14 per share in the full year of 2003 and $.14 per share in 2002.

Net income in the years presented was affected by the following items, which are presented on an after-tax basis:

Twelve Months Ended December 31, 2004:

A charge of $47.6 million or $.14 per diluted share for the cumulative effects of accounting changes primarily related to the implementation of FIN 46R and a change in our pension accounting.

Expenses of $38.7 million or $.11 per diluted share associated with the settlement of certain litigation matters.

Net gain on dispositions of $53.2 million or $.16 per diluted share (including tax benefits realized from the dispositions of our French operations and our minority interest in a United Kingdom company).

Net loss on the early extinguishment of debt of $10.5 million or $.03 per diluted share primarily related to the successful tender offer of our notes due 2005 and the redemption of our convertible notes due 2008.

Income tax benefit of $7.9 million or $.02 per diluted share related to state net operating losses.

Foreign currency transactional loss of $2.3 million or $.01 per diluted share associated with the payment of a contingent purchase obligation in Chile.

Interest income of $2.7 million or $.01 per diluted share related to interest income on a note receivable from our former United Kingdom company.

Discontinued operations contributed net earnings of $43.8 million or $.13 per diluted share.

Twelve Months Ended December 31, 2003:

Expenses of $61.0 million or $.21 per diluted share related to outstanding litigation matters.

Net gain on dispositions of $32.7 million or $.11 per diluted share primarily related to the sale of our equity and debt holdings in our former Australian company.

Net gain on corporate investments of $2.6 million or $.01 per diluted share.

Other operating expense of $5.9 million or $.02 per diluted share related to severance costs and the termination of a lease contract.

Net gain on the early extinguishment of debt of $0.7 million or less than $.01 per diluted share.

Discontinued operations contributed net earnings of $2.5 million or $.01 per diluted share.

Twelve Months Ended December 31, 2002:

A charge of $135.6 million or $.46 per diluted share for the cumulative effects of accounting changes related to the impairment of goodwill in our North America cemetery segment.

Net loss on dispositions of $116.2 million or $.40 per diluted share primarily related to an impairment charge for several funeral and cemetery operations held for sale in North America.

Other operating expenses of $67.3 million or $.23 per diluted share related to market value adjustments of certain options associated with our 6.3% notes due 2003, severance costs of former employees, and expenses related to the termination of certain consulting and non-compete contractual obligations.

Net gain on the early extinguishment of debt of $4.9 million or $.02 per diluted share.

Discontinued operations reported a net loss of $14.8 million or $.05 per diluted share.

The consolidated effective tax rate in 2004 was a benefit of 5.0% compared to an expense of 25.8% in 2003 and a benefit of 31.6% in 2002. The tax rate in 2004 was favorably impacted by tax benefits realized from the disposition of our operations in France and the United Kingdom and state net operating losses realized in 2004. The tax benefits from dispositions result from differences between book and tax basis and the reversal of tax liabilities that were then recorded as warranty indemnification liabilities. In 2005, we expect the consolidated effective tax rate for continuing operations to be approximately 35%.

The diluted weighted average number of shares increased to 344.7 million in 2004 compared to 300.8 million in 2003 and 294.5 million in 2002. This increase is mainly due to the conversion in June 2004 of our convertible senior notes which resulted in the issuance of approximately 32 million shares, which were anti-dilutive in 2003 and 2002. The remaining share increase is related to dilutive outstanding stock options and the contribution of common stock to our 401(k) retirement plan, which was partially offset by share repurchases. In 2005, we intend to reduce the number of shares outstanding through our previously announced share repurchase programs. Also effective January 1, 2005, we began to contribute cash to fund the Company s matching contribution to its 401(k) retirement plan and discontinued funding through the use of common stock.

Consolidated Funeral Results

Funeral revenues in 2004 declined $479.9 million from 2003 primarily due to a decline of $457.3 million in revenues associated with our French funeral operations, which were sold on March 11, 2004. In 2003, revenues from funeral operations in France were $584.6 million compared to $127.3 million for the partial period of our ownership from January 1, 2004 through March 11, 2004. North America funeral revenue declined $23.7 million primarily as a result of divestitures and an $8.5 million decline in revenues from Kenyon, our subsidiary that engages in mass fatality and emergency response services. Kenyon revenues were higher in 2003 than in 2004 primarily due to activity associated with the World Trade Center disaster.

Funeral gross profits decreased $46.8 million in 2004 compared to 2003 primarily as a result of a $56.7 million decline in gross profits related to our former French operations which were sold in March 2004. Gross profits from our French funeral operations were $11.6 million in our partial period of ownership in 2004 compared to $68.3 million in the full year of 2003. North America funeral gross profits increased $11.3 million despite a decline in revenues. This improvement is mainly a result of reduced overhead costs and lower pension expenses benefited by a change in pension accounting, which were partially offset by declines in Kenyon revenue.

Funeral revenues increased $59.8 million in 2003 compared to 2002 as a result of a $97.3 million increase in foreign revenues, partially offset by a decline of $37.5 million in North America funeral revenues. The increase in foreign revenues is predominantly related to our French operations and is due to increases in funeral services performed and in the average revenue per funeral, as well as favorable currency effects. North America funeral revenues declined primarily as a result of divestitures and declines in General Agency (GA) revenues. GA revenues are commissions we receive from third-party insurance companies when customers purchase insurance contracts from such third-party insurance companies to fund funeral services and merchandise at a future date.

Funeral gross profits declined $10.8 million in 2003 compared to 2002. Declines in North America funeral operations due to decreased revenues described above and increases in employee benefit and insurance costs were partially offset by improvements in French funeral operations which benefited from increased revenues described above and reduced depreciation expense.

Table of Contents

Consolidated Cemetery Results

Cemetery revenues increased $2.7 million in 2004 compared to 2003; however, North America cemetery revenues decreased $2.1 million. Foreign cemetery revenues (consisting of cemetery operations in Chile) increased $4.8 million reflective of improved economic conditions in the region and favorable currency effects. Cemetery gross profits increased $21.4 million in 2004 compared to 2003 and benefited from an increase in revenues described above and reductions in North America overhead costs, pension expenses and maintenance expenses.

Cemetery revenues declined $32.6 million in 2003 compared to 2002 primarily as a result of a $37.5 million decrease in North America cemetery revenues, partially offset by improvements in foreign cemetery revenues. This decline in North America cemetery revenues was due to divestitures and also due to the significant changes made to the sales organization in 2003. Although we expected cemetery revenues to decline in 2003 from these strategic changes, we also anticipated, and realized, higher gross margins as a result. Cemetery gross profits in 2003 improved $12.1 million from 2002 due primarily to reductions in preneed selling costs from a number of changes made to the sales organization to increase our effectiveness.

General and Administrative Expenses

General and administrative expenses were $130.9 million in 2004 compared to $178.1 million in 2003 and $89.8 million in 2002. Included in all periods are expenses associated with the settlement of certain litigation matters. We recognized litigation expenses (net of insurance recoveries of $1.6 million in 2004, $25.0 million in 2003 and $0 in 2002) of $61.1 million in 2004 compared to $95.2 million in 2003 and $10.0 million in 2002. Additionally, in both 2003 and 2002 we recognized approximately $14 million of accelerated system amortization expense that is not included in 2004. During 2002, we made the decision to implement new information technology systems and, therefore, accelerated the amortization of the old systems. These accelerated amortization costs ceased at the end of the third quarter of 2003 when amortization of the new systems commenced.

Excluding litigation expenses and accelerated system amortization costs in all periods, general and administrative expenses in 2004 were $69.8 million compared to $69.1 million in 2003 and $66.3 million in 2002. Increased costs associated with Sarbanes-Oxley compliance efforts were offset by reductions in information technology and other overhead expenses. General and administrative expenses excluding litigation expenses and accelerated system amortization costs is a non-GAAP financial measure; however, we believe this non-GAAP measure is useful to investors as it provides a consistent basis for comparison between periods and better reflects the performance of our core operations, as it is not influenced by certain non-recurring expenses.

Other

In 2004, we recognized a net pretax gain from dispositions of $25.8 million consisting of a $41.2 million gain from the sale of our equity and debt holdings in our former United Kingdom company and a $6.4 million gain from the sale of our French funeral operations, partially offset by net losses associated with various dispositions in North America. In 2003, we recognized a net pretax gain of $49.7 million primarily related to the sale of our equity holdings in our former operations in Australia and Spain. In 2002, we recognized a net pretax loss of $163.2 million primarily related to an impairment charge for certain funeral and cemetery operations held for sale in North America. For further information regarding gains and impairment losses on dispositions see note twenty to the consolidated financial statements in this Form 10-K/A (Amendment No. 2).

In 2003, we recognized other operating expenses of $9.0 million related to severance costs and the termination of a lease contract. In 2002, we recognized other operating expenses of $94.9 million related to market value adjustments of certain options associated with our 6.3% notes due 2003, severance costs of former employees, and expenses related to the termination of certain consulting and non-compete contractual obligations.

Interest expense decreased to $118.2 million in 2004 compared to $138.6 million in 2003 and $158.0 million in 2002. Between 2002 and 2004, interest expense declined by $39.8 million or 25.2%, reflecting the success we have had in improving our balance sheet. During this same period, total debt was reduced by more than $700 million as a result of strong operating cash flows and a successful asset divestiture and joint venture program that produced more than $500 million of net cash proceeds.

Other income was $16.1 million in 2004 compared to $24.3 million in 2003 and $14.5 million in 2002. The components of other income for the years presented were as follows:

Interest income was $13.5 million in 2004 compared to $14.4 million in 2003 and $7.1 million in 2002.

Cash overrides received from a third party insurance provider related to the sale of insurance funded preneed funeral contracts were $6.3 million in 2004 compared to $5.6 million in 2003 and $9.5 million in 2002. For a further description of these cash overrides, see *Insurance Funded Preneed Funeral Contracts* in Item 7 of this Form 10-K/A (Amendment No. 2).

Table of Contents

In 2004, we recognized a $2.8 million foreign currency transactional loss associated with the payment of a contingent purchase obligation in Chile.

Surety bond premium costs were $4.0 million in 2004 compared to $4.1 million in 2003 and $2.9 million in 2002.

The remaining income of $3.1 million in 2004, $8.4 million in 2003, and $1.9 million in 2002, is primarily attributable to net gains related to foreign currency transactions.

Actual Versus Comparable Results of Operations Twelve Months Ended December 31, 2004, 2003 and 2002

The table below reconciles our actual results to our comparable or same store results for the periods ended December 31, 2004, 2003 and 2002. We regard same store results of operations as analogous to our comparable results of operations. We consider comparable operations as operations that were not acquired or constructed after January 1, 2002 or divested prior to December 31, 2004. Therefore, in the following three-year presentation, we are providing results of operations for the same funeral and cemetery locations. Comparable results are a non-GAAP financial measure; however, we believe this non-GAAP measure is useful to investors as it provides a consistent basis for comparison between periods and better reflects the performance of our core operations.

(Dollars in thousands)	**Actual** (Restated)	**Activity associated with acquisition / new construction**	**Activity associated with dispositions**	**Comparable** (Restated)	**% Variance**
2004					
North America					
Funeral revenue	$ 1,120,128	$ 1,370	$ 11,714	$ 1,107,044	1.2%
Cemetery revenue	570,135		4,250	565,885	0.7%
	1,690,263	1,370	15,964	1,672,929	1.0%
Other foreign					
Funeral revenue	139,693		127,282	12,411	91.1%
Cemetery revenue	30,906			30,906	0.0%
	170,599		127,282	43,317	74.6%
Total revenues	$ 1,860,862	$ 1,370	$ 143,246	$ 1,716,246	7.8%
North America					
Funeral gross profits	$ 213,290	$ 332	$ (2,842)	$ 215,800	(1.2)%
Cemetery gross profits	101,997		(5,154)	107,151	(5.1)%
	315,287	332	(7,996)	322,951	(2.4)%
Other foreign					
Funeral gross profits	13,117		11,572	1,545	88.2%

Cemetery gross profits	7,806			7,806	0.0%
	20,923		11,572	9,351	55.3%
Total gross profit	$ 336,210	$ 332	$ 3,576	$ 332,302	1.2%

Table of Contents

(Dollars in thousands)	**Actual** (Restated)	**Activity associated with acquisition / new construction**	**Activity associated with dispositions**	**Comparable** (Restated)	**% Variance**
2003					
North America					
Funeral revenue	$ 1,143,831	$ 480	$ 33,547	$ 1,109,804	3.0%
Cemetery revenue	572,219		10,461	561,758	1.8%
	1,716,050	480	44,008	1,671,562	2.6%
Other foreign					
Funeral revenue	595,937		584,636	11,301	98.1%
Cemetery revenue	26,075			26,075	0.0%
	622,012		584,636	37,376	94.0%
Total revenues	$ 2,338,062	$ 480	$ 628,644	$ 1,708,938	26.9%
North America					
Funeral gross profits	$ 202,000	$ 59	$ (1,624)	$ 203,565	(0.8)%
Cemetery gross profits	82,565		(555)	83,120	(0.7)%
	284,565	59	(2,179)	286,685	(0.7)%
Other foreign					
Funeral gross profits	71,165		68,275	2,890	95.9%
Cemetery gross profits	5,829			5,829	0.0%
	76,994		68,275	8,719	88.7%
Total gross profit	$ 361,559	$ 59	$ 66,096	$ 295,404	18.3%

(Dollars in thousands)	**Actual** (Restated)	**Activity associated with acquisition / new construction**	**Activity associated with dispositions**	**Comparable** (Restated)	**% Variance**
2002					

North America					
Funeral revenue	$ 1,181,295	$	$ 65,444	$ 1,115,851	5.5%
Cemetery revenue	609,724		26,363	583,361	4.3%
	1,791,019		91,807	1,699,212	5.1%
Other foreign					
Funeral revenue	498,671		487,926	10,745	97.8%
Cemetery revenue	21,190		2,190	19,000	10.3%
	519,861		490,116	29,745	94.3%
Total revenues	$ 2,310,880	$	$ 581,923	$ 1,728,957	25.2%
North America					
Funeral gross profits	$ 230,980	$	$ 3,118	$ 227,862	1.3%
Cemetery gross profits	71,078		3,416	67,662	4.8%
	302,058		6,534	295,524	2.2%
Other foreign					
Funeral gross profits	52,955		50,217	2,738	94.8%
Cemetery gross profits	5,186		740	4,446	14.3%
	58,141		50,957	7,184	87.6%
Total gross profit	$ 360,199	$	$ 57,491	$ 302,708	16.0%

Table of Contents

The following table provides the components to calculate our comparable average revenue per funeral service in North America for the periods ended December 31, 2004, 2003 and 2002. We calculate average revenue per funeral service as adjusted comparable North America funeral revenue divided by the comparable number of funeral services performed in North America during the applicable period. In the calculation of average revenue per funeral service, General Agency (GA) revenues and Kenyon revenues are excluded from comparable North America funeral revenue to avoid distorting our averages of normal funeral case volume.

(Dollars in thousands, except average revenue per funeral service)	**2004** (Restated)	**2003** (Restated)	**2002** (Restated)
Comparable North America funeral revenue	$ 1,107,044	$ 1,109,804	$ 1,115,851
Less: GA revenues (1)	28,888	27,612	45,971
Kenyon revenues (2)	3,442	11,945	4,996
Adjusted Comparable North America funeral revenue	$ 1,074,714	$ 1,070,247	$ 1,064,884
Comparable North America funeral services performed	252,232	257,591	261,389
North America average revenue per funeral service	$ 4,261	$ 4,155	$ 4,074

(1) General Agency (GA) revenues are commissions we receive from third-party insurance companies when customers purchase insurance contracts from such third-party insurance companies to fund funeral services and merchandise at a future date.

(2) Kenyon International Emergency Services (Kenyon) is our disaster response subsidiary that engages in mass fatality and

emergency response services. Revenues and gross profits associated with Kenyon are subject to significant variation due to the nature of their operations.

North America Comparable Results of Operations

Other foreign revenues and gross profits shown above are primarily related to our funeral operations in France which were sold in March 2004. Since we did not own these businesses for the full year of 2004, they are not considered comparable or same store locations.

In 2004, comparable North America operations represented 90% of consolidated revenues and approximately 96% of consolidated gross profits. The following discussion of results of operations pertains to comparable North America operations only.

Comparable North America Funeral

Comparable North America funeral revenues in 2004 declined $2.8 million or less than 1% from 2003 primarily due to an $8.5 million decrease in revenues from Kenyon and a decline in funeral volume, which was partially offset by an increase in the average revenue per funeral service and an increase in GA revenue. Comparable North America funeral revenues declined $6.0 million in 2003 compared to 2002 primarily as a result of an $18.4 million decline in GA revenue and a decline in funeral volume, which was partially offset by a $6.9 million increase in Kenyon revenue and an increase in the average revenue per funeral service. GA revenue declined during 2003 as a result of an anticipated decrease in the sale of insurance funded preneed funeral contracts due to significant changes made to the sales organization in 2003 which impacted our sales effectiveness.

The number of funeral services performed declined 2.1% in 2004 compared to 2003 which in turn was down 1.5% from 2002. We believe these declines are consistent with trends reported by other companies in the funeral service and casket manufacturing industries and that these declines are primarily related to a decrease in the number of deaths in our relevant markets. Our review of various sources of industry data indicates that market share has increased in certain of our markets and decreased in others; however, we believe that there has not been a substantial loss of market share in our total North America business segment. We believe that over time, the decline in our North America comparable funeral services performed will be curtailed as a result of the aging of the population and the number of initiatives we have in place to grow market share. For a further description of our initiatives to grow revenues, see The Path to Growth earlier in this Item of this Form 10-K/A (Amendment No. 2).

The comparable average revenue per funeral service increased 2.6% in 2004 over 2003 and increased 2.0% in 2003 over 2002. The fourth quarter of 2004 represents the eighteenth consecutive quarter that we have reported an increase in our average revenue per funeral service. This consistent growth in average revenue is largely a result of the success of our nationally branded Dignity Memorial® packaged funeral and cremation plan initiative. The Dignity® plans are focused on adding value for the consumer instead of relying on price increases. These plans offer consumers unique products and services aimed at providing assistance with administrative and legal issues, travel needs, emotional support, and memorialization when a death occurs. Because of these comprehensive value-added offerings, the packages generate significant incremental revenue per funeral service compared to non-Dignity sales. The percentage of consumers selecting a Dignity Memorial® plan has grown from approximately 14% of the total funeral services performed in 2002 to approximately 17% in 2004. We believe we can increase the selection rate of Dignity Memorial® plans in 2005 by continuing to utilize technology and contemporary marketing techniques to enhance our sales opportunities.

We have been able to generate increases in the average revenue per funeral despite an increase in the rate of cremation. Of the total comparable funeral services performed in 2004, 40.0% were cremation services versus 39.0% in the same period of 2003 and 37.9% in 2002. In North America, there continues to be a growing trend in the number of cremations performed as an alternative to traditional funeral service dispositions. Cremation services historically have generated less revenue and gross profit dollars than traditional funeral services that involve burials. Industry research has shown that most consumers choose cremation for reasons other than cost, which we believe provides us significant opportunities to better serve the cremation consumer. Our Dignity Memorial® packaged cremation plans have been successful in expanding the products and services that cremation consumers select. Of the total cremation services performed during 2004, approximately 12% were Dignity Memorial® cremation plans.

Despite a decline in funeral revenues in 2004, funeral gross profits improved 6.0% and the funeral gross margin percentage improved to 19.5% in 2004 compared to 18.3% in 2003. This improvement is mainly a result of reduced overhead and pension expenses which were partially offset by declines in Kenyon revenue described above. North America funeral gross profits and gross margin percentage declined in 2003 compared to 2002 primarily due to increased employee benefit costs and insurance costs, which were partially offset by reductions in selling and other overhead costs.

Comparable North America Cemetery

We demonstrated significant progress in 2004 in our cemetery segment. North America cemetery revenue increased $4.1 million or 1% from 2003 to $565.9 million. This exceeded our original expectations and was primarily a result of increased recognition of undeveloped property that was sold in 2004 and then subsequently constructed during 2004. This is mainly attributable to the success of our focus on developing and selling high-end cemetery property such as private family estates. Revenues from the sale of cemetery property are recognized only when the property is fully developed and when customer payments are at least 10% of the total contract amount. Historically, the sale of undeveloped property preceded the period of final construction and revenue recognition by as much as five years. We are shifting our strategy to focus on shortening the time between when property is sold and when it is constructed.

Cemetery revenues declined $21.6 million in 2003 compared to 2002 primarily as a result of the anticipated decrease in preneed revenues due to significant changes made to the sales organization in 2003. Although we expected revenues to decline in 2003, we also anticipated, and realized, higher gross margins as a result of those strategic changes.

Cemetery gross profits increased 28.9% or $24.0 million in 2004 compared to 2003 and benefited from an increase in revenues and reductions in overhead costs, pension expenses and maintenance expenses. Cemetery gross profits in 2003 improved $15.5 million from 2002 due primarily to reductions in preneed selling costs from a number of changes made to the sales organization to increase effectiveness. The cemetery gross margin percentage grew to 18.9% in 2004 from 14.8% in 2003 and 11.6% in 2002.

Overhead and Pension Expenses

The improvement in funeral and cemetery gross profits in 2004 compared to 2003 and 2002 is largely a result of a reduction in overhead expenses and pension expenses. Overhead expenses from our field management and support offices and our home office are allocated to funeral and cemetery operations in North America. In 2004, these overhead expenses totaled $112.6 million compared to $152.7 million in 2003 and $162.9 million in 2002, representing a decline of $50.3 million from 2002 to 2004.

Beginning in late 2002 and continuing through 2003, we moved to reduce our fixed costs by reformulating our infrastructure. We redesigned our sales organization, improved business and financial processes, and outsourced certain of our accounting functions. In 2003 and continuing through 2004, we implemented a new information system in our field locations. In late 2003, we eliminated the dual management structures of sales and operations and replaced them with a single-line business management structure. In addition to reducing costs, this new structure now has our strongest business managers focused on producing favorable financial results in each of our markets.

Pension income and expense, of which a portion is included in funeral and cemetery expenses and a portion in general and administrative expenses, is related to our frozen cash balance pension plan and its supplemental retirement plans for certain current and former employees. We recognized pension income of $0.3 million in 2004 compared to pension expense of $17.6 million and pension expense of $6.7 million in 2002. The reduction in net pension expense in 2004 compared to 2003 and 2002 is primarily related to a change in accounting. Effective January 1, 2004, we changed the accounting for gains and losses on our pension plan assets and obligations to recognize such gains and losses as they are incurred. Prior to January 1, 2004, we amortized the difference between actual and expected investment returns and actuarial gains and losses over seven years (except to the extent that settlements with employees required earlier recognition). We believe the new method of accounting better reflects the economic nature of our pension plans and recognizes gains and losses on the pension plan assets and liabilities in the year the gains or losses occur. For further information regarding our pension plans, see note sixteen in Item 8 of this Form 10-K/A (Amendment No. 2).

Financial Condition, Liquidity and Capital Resources

Overview

Our primary financial objectives are to capitalize on our financial flexibility and to continue generating strong operating cash flows. We believe that we have adequate resources to meet our near and intermediate term debt obligations, planned capital expenditures and other cash requirements, as well as to have funds available for future growth. As of December 31, 2004, our cash balance was approximately $288 million. We also have a $200 million credit facility that was executed in August 2004. We have no cash borrowings under this credit facility, but have used it to support $67.0 million of letters of credit as of December 31, 2004.

Internally generated cash flows are a significant source of liquidity for us. Cash flow from operating activities in 2004 was $107.8 million. Included in 2004 was the payment of $131.1 million related to the resolution of certain legal matters, a $20.0 million voluntary cash contribution to our pension plan, and the payment of $11.4 million to retire life insurance policy loans related to our SERP and Senior SERP retirement programs. Excluding these items, cash flow from operating activities was $270.3 million. Cash flows from operating activities that exclude the items described above is a non-GAAP financial measure; however, we believe this non-GAAP measure is useful to investors as it better reflects the performance of our core operations, as it is not influenced by certain non-recurring expenses.

We are continuing our program to divest of our operations outside of North America. In February 2005, we sold our operations in Argentina and Uruguay for net cash proceeds of $21.6 million. We currently own funeral businesses in Germany and Singapore and cemetery businesses in Chile, all of which we would consider holding for sale if we believe appropriate values could be obtained; however, these businesses are not currently being held for sale. We expect these future international asset sales could generate $60 to $80 million of net cash proceeds if and when sold.

In March 2005, we received a tax refund of $29.0 million resulting from certain federal tax carry-back losses.

Total debt at December 31, 2004 was $1.25 billion. We currently have about $75 million of debt maturing in 2005 and approximately $164 million in 2006. We have a credit rating of BB with Standard and Poor s (S&P) and Ba3 with Moody s Investors Service (Moody s). In addition, Moody s upgraded SCI during 2004 to its highest Speculative Grade Liquidity rating of SGL-1 . We believe these current ratings provide us with adequate access to obtain funds at a reasonable cost, if necessary.

Capital Allocation Considerations

We believe that our financial flexibility coupled with our liquidity allows us to consider investments or capital structure related transactions that will enhance shareholder value. In February 2005, we initiated a quarterly cash dividend of two and one-half cents per share of common stock. While we intend to pay regular quarterly cash dividends for the foreseeable future, all subsequent dividends are subject to final determination by the Board of Directors of SCI each quarter after its review of our financial performance. We intend to continue to buy back our common stock as discussed further below. We will continue to evaluate internal opportunities such as the construction of new funeral homes and development of high-end cemetery property. We will look at acquisitions that meet the strategic needs of our core business, if such acquisitions are available at reasonable market prices. These investment decisions will require projected returns at a premium to our weighted average cost of capital. Finally, we could consider additional debt reductions depending on acceptable market conditions.

In August 2004, we announced our initial share repurchase program authorizing the investment of up to $100 million to repurchase our common stock. In November 2004, we announced the authorization of an additional $100 million. In February 2005, the authorization was increased by another $100 million for an aggregate of $300 million. As of March 31, 2005, we had repurchased approximately 31.4 million shares at a total cost of approximately $213.8 million under these programs. We have made and intend to make purchases from time to time in the open market or through privately negotiated transactions, subject to acceptable market conditions and normal trading restrictions. There can be no assurance that we will continue to buy our common stock under our share repurchase programs. Important factors that could cause us not to continue to repurchase our shares include, among others, unfavorable market conditions, the market price of our common stock, the nature of other investment opportunities presented to us from time to time, and the availability of funds necessary to continue purchasing common stock.

During the third quarter of 2004, we made our first strategic acquisition since 1999 for $1.8 million in cash plus other consideration. We will continue to look for attractive acquisition opportunities to complement our internal growth initiatives; however, we anticipate only modest activity due to elevated price expectations of potential sellers.

Cash Flow

We believe our ability to generate strong operating cash flow is one of our fundamental financial strengths and provides us with substantial flexibility in meeting operating and investing needs. Highlights of cash flow for the year ended December 31, 2004 compared to the same period of 2003 are as follows:

Operating Activities Cash flows from operating activities declined by $266.3 million to $107.8 million in 2004 compared to 2003. Included in 2004 was the payment of $131.1 million related to the resolution of certain litigation matters, a $20.0 million voluntary cash contribution to our pension plan, and the payment of $11.4 million to retire life insurance policy loans related to our SERP and Senior SERP retirement programs. Included in 2003 was a tax refund of $94.5 million and disbursements of $27.1 million (net of insurance recoveries) related to the resolution of certain litigation matters. Excluding the items described above in both periods, cash flows from operating activities declined $36.4 million. Cash flows from operating activities that exclude the items described above is a non-GAAP financial measure; however, we believe this non-GAAP measure is useful to investors as it provides a consistent basis for comparison between periods and better reflects the performance of our core operations, as it is not influenced by certain non-recurring expenses.

A portion of this $36.4 million decline is attributable to our French business which was divested in March 2004. Cash flow from operating activities in France declined $14.7 million from $33.0 million in 2003 to $18.3 million for the period January 1, 2004 through March 11, 2004. The remaining decline of $21.7 million is primarily a result of decreases associated with an extra cash payroll payment of $19.2 million in 2004, the replacement of bonding with trust funding for new preneed sales in Florida and working capital increases primarily associated with decreases in accounts receivable collections. These declines were partially offset by reductions in interest and tax payments.

We incurred an extra bi-weekly cash payroll payment of $19.2 million in 2004 that did not occur in 2003. This extra bi-weekly cash payroll payment occurs every eleven years and is not expected to recur until the year 2015.

In February 2004, we began making net trust deposits in Florida for our new preneed funeral and cemetery sales and discontinued the use of surety bonding as our primary financial assurance mechanism. Net trust deposits to preneed funeral and cemetery merchandise and service trusts were $15.4 million for new sales in Florida in 2004. No trust deposits to preneed funeral and cemetery merchandise and service trusts were made for new Florida sales in 2003, as we used surety bonding in 2003.

Cash interest payments declined $25.6 million to $111.0 million in 2004 compared to $136.6 million in the same period of 2003 due to significant debt reductions during 2004. We did not pay federal income taxes in 2003 or 2004. Because of our significant net operating loss carry-forwards and future tax losses anticipated from proposed international asset sales, we do not expect to pay federal income taxes until 2007. Foreign, state and local income tax payments declined $3.7 million in 2004 to $10.8 million from $14.5 million in 2003 primarily as a result of less foreign taxes paid due to the disposition of our French operations. These reductions in interest and tax payments were offset by working capital increases primarily associated with decreases in accounts receivable collections and expenses associated with Sarbanes-Oxley compliance.

Investing Activities Cash flows from investing activities improved by $326.9 million primarily due to an increase in proceeds from sales of international businesses and equity investments (described below) and net withdrawals from restricted funds primarily related to various commercial commitments (described below). Partially offsetting these increases was the payment of $51.7 million to satisfy a contingent purchase obligation associated with the 1998 acquisition of our operations in Chile. Capital spending declined $19.6 million and was offset by $18.8 million in reduced proceeds from divestitures and sales of property and equipment.

In March 2004, we sold our funeral operations in France. In addition to maintaining a 25% share of the total equity capital of the newly formed entity, we received net cash proceeds of $281.7 million. Following a successful public offering transaction of our former United Kingdom affiliate during the second quarter of 2004, we liquidated our debt and equity holding in our former United Kingdom affiliate and collected $53.8 million in aggregate of which $49.2 million is reported as an investing activity and the remaining balance was reported in *Other income, net* in the consolidated statement of operations as of March 31, 2004.

In 2003, we made certain restricted cash deposits as a result of our decision to replace certain letters of credit with cash collateral for various commercial commitments (primarily surety obligations). Our improved financial condition and credit profile in 2004 allowed us to receive $74.9 million of this cash collateral back. In early 2005, we received an additional $9.2 million of cash collateral back and have no further deposits outstanding for cash collateral with surety companies.

Financing Activities Cash used for financing activities increased $49.5 million and is primarily due to debt extinguishments and stock repurchases.

In 2004, we executed a series of transactions to further strengthen our capital structure. In April 2004, we successfully completed a private offering of $250 million principal amount of 6.75% notes due 2016 (these notes were subsequently exchanged for publicly-traded notes) and received net cash proceeds of approximately $243 million. Including the premium, $219.0 million of the net cash proceeds were applied to the early retirement of $208.7 million in principal of our 6% notes due 2005. Immediately following the June 22, 2004 conversion into common stock of approximately 71% of our outstanding 6.75% bonds due 2008, we exercised our option to redeem the remaining outstanding $91.1 million of the bonds for $94.6 million in cash, including interest and a premium. Also in 2004, as required by the terms of the agreements, we repaid the remaining $111.2 million of our 7.375% notes due April 2004 and $50.8 million of our 8.375% notes due December 2004. With these transactions in 2004, we have significantly extended our debt maturity schedule, reduced our future interest payments and increased our financial flexibility, continuing the progress we have made on improving our balance sheet.

During the period August 16, 2004 to December 31, 2004, we repurchased 16.7 million shares of common stock for $110.3 million. Between January 1 and March 31, 2005, we repurchased an additional 14.7 million shares for $103.5 million. As of March 31, 2005, the remaining dollar value of shares that may yet be purchased under our share repurchase programs was approximately $86 million.

Taxes

We had tax receivables of $30.5 million and long-term tax liabilities of $105.0 million at December 31, 2004. Current refundable income taxes and current deferred tax assets are included in *Other current assets*, while long-term deferred tax assets are included in *Deferred charges and other assets* in the consolidated balance sheet. Current taxes payable and current deferred tax liabilities are reflected as *Income taxes* in the consolidated balance sheet and long-term tax liabilities are included in *Other liabilities* in the consolidated balance sheet. We maintain accruals for tax liabilities that relate to uncertain tax matters in numerous countries. If these tax matters are unfavorably resolved, we will make any required payments to tax authorities or adjust the deferred tax asset. If these tax matters are favorably resolved, the accruals maintained by the Company will no longer be required and these amounts will be reversed through the tax provision as a non-cash credit at the time of resolution.

Debt

Our financial condition continues to improve as demonstrated by the following trend in our cash and debt balances at December 31:

	December 31,			
(In millions)	**2004**	**2003**	**2002**	**2001**
Total debt	$ 1,254.0	$ 1,701.9	$ 1,974.4	$ 2,522.0
Cash and cash equivalents	287.8	239.4	200.6	29.3
Total debt less cash and cash equivalents	$ 966.2	$ 1,462.5	$ 1,773.8	$ 2,492.7

In 2004, we continued to increase our cash balance while simultaneously reducing our total debt. Total debt less cash and cash equivalents (or net debt) at December 31, 2004 was $966.2 million, representing the lowest levels in our company since 1992. Net debt has been reduced by approximately $1.5 billion or more than 60% since December 31, 2001. This reduction is a result of strong operating cash flows and a successful asset divestiture and joint venture program that produced over $900 million of net cash proceeds.

Contractual, Commercial and Contingent Commitments

We have assumed various financial obligations and commitments in the ordinary course of conducting our business. We have contractual obligations requiring future cash payments under existing contractual arrangements, such as management, consulting and non-competition agreements. We also have commercial and contingent obligations that result in cash payments only if certain contingent events occur requiring our performance pursuant to a funding commitment.

Table of Contents

The following table details our known future cash payments (on an undiscounted basis) related to various contractual obligations as of December 31, 2004.

(Dollars in thousands)		Payments Due By Period			
Contractual Obligations	**2005**	**2006 - 2007**	**2008 - 2009**	**Thereafter**	**Total**
Current maturities of long-term debt (1)	$ 75,075	$	$	$	$ 75,075
Long-term debt (1)		313,944	559,829	305,112	1,178,885
Interest obligation on long-term debt	94,998	157,984	89,213	156,405	498,600
Casket purchase agreement (2)	121,707				121,707
Operating lease agreements (3)	36,002	54,867	34,921	86,907	212,697
Management, consulting and non-competition agreements (4)	30,866	29,015	6,462	4,360	70,703
Total contractual obligations	$ 358,648	$ 555,810	$ 690,425	$ 552,784	$ 2,157,667

(1) Our outstanding indebtedness contains standard provisions, such as payment delinquency default clauses and change of control clauses. In addition, our bank credit agreement contains a maximum leverage ratio and a minimum interest coverage ratio.

(2) We have executed a purchase agreement with a major casket manufacturer for our North America operations with an original minimum

commitment of $750 million, covering a six-year period, that expired in 2004. The agreement contained provisions for annual price adjustments and provided for a one-year extension to December 31, 2005 in which we are allowed to satisfy any remaining commitment that exists at the end of the original term. We elected to extend the contract to December 31, 2005 in order to satisfy its minimum commitment. In January 2005, we amended our original purchase agreement. This amendment allows us to continue purchasing caskets through 2006, subject to price increase limitations. At December 31, 2004, our remaining commitment under the purchase agreement was $121.7 million.

(3) The majority of our operating leases contain options to (i) purchase the property at fair value on the exercise date, (ii) purchase the property for a value determined at the inception of the leases, or (iii) renew for the fair rental value at the end of the primary lease term. Our operating leases primarily relate to funeral service locations, automobiles, limousines, hearses, cemetery operating and maintenance equipment and two aircraft. We have residual value exposures related to certain operating leases of approximately \$7.8 million. We believe it is unlikely that we will have to make future cash payments related to these residual value exposures.

(4) We have entered into management employment, consulting and non-competition agreements which

contractually require us to make cash payments over the contractual period. The agreements have been primarily entered into with certain officers and employees of the Company and former owners of businesses acquired. The contractual obligation amounts pertain to the total commitment outstanding under these agreements and may not be indicative of future expenses to be incurred related to these agreements due to cost rationalization programs completed by the Company.

We have not included amounts in this table for payments of pension contributions and payments for various postretirement welfare plans and postemployment benefit plans, as such amounts have not been determined beyond 2005. Furthermore, we have not presented the amounts associated with these obligations for 2005 since we are not required to make any payments to the plans.

The following table details our known potential or possible future cash payments (on an undiscounted basis) related to various commercial and contingent obligations as of December 31, 2004.

(Dollars in thousands)		Expiration By Period			
Commercial and Contingent Obligations	**2005**	**2006 - 2007**	**2008 - 2009**	**Thereafter**	**Total**
Surety obligations [1]	$ 258,349	$	$	$	$ 258,349
Letters of credit [2]	66,985				66,985
Representations and warranties [3]	19,836	36,480			56,316
Total commercial and contingent obligations	$ 345,170	$ 36,480	$	$	$ 381,650

(1) To support our operations, we have engaged certain surety companies to issue surety bonds on our behalf for customer financial assurance or as required by state and local regulations. The surety bonds are primarily obtained to provide assurance for our preneed funeral and preneed cemetery obligations, which are appropriately presented as liabilities in the consolidated balance sheet as *Deferred preneed funeral contract revenues* and *Deferred cemetery contract revenues*. The total outstanding surety bonds at December 31, 2004 were \$353 million. Of this amount, \$342 million was related to preneed funeral and preneed cemetery

obligations. When we use surety bonds for preneed funeral and cemetery obligations, the bond amount required is based on the trusting requirements calculated as if the contract was paid in full at the time of sale. When we deposit funds into state-mandated trust funds, however, the amount deposited is generally based on the amount of cash received and payment application rules in the state trust requirements. Therefore, in the event all of the surety companies canceled or did not renew our outstanding surety bonds, which are generally renewed for twelve-month periods, we would be required to either obtain replacement assurance or fund approximately \$258 million, as of December 31, 2004, primarily into state-mandated trust accounts. At this time, we do not believe we will be required to fund material future amounts related to these surety bonds.

(2) We are occasionally required to post letters of credit, issued by a financial institution, to secure certain insurance programs or other obligations. Letters of credit generally authorize the financial institution to make a payment to the beneficiary upon the satisfaction of a certain event or the failure to satisfy an obligation. The letters of credit are generally posted for 1-year terms and are usually automatically renewed upon maturity until such time as we have satisfied the commitment secured by the letter of credit. We are obligated to reimburse the issuer only if the beneficiary collects on the letter of credit. We believe that it is unlikely we will be required to fund a claim

under our outstanding letters of credit. In 2004, the full amount of the letters of credit was supported by our credit facility which expires August 2007.

(3) In addition to the letters of credit described above, we currently have contingent obligations of $56.3 million related to our asset sale and joint venture transactions. We have agreed to guarantee certain representations and warranties associated with such disposition transactions with letters of credit or interest bearing cash investments. We have interest bearing cash investments of $11.8 million included in *Deferred charges and other assets* pledged as collateral for certain of these contingent obligations. We do not believe we will ultimately be required to fund to third parties claims against

these representations and warranties above the carrying value of the liability. During the year ended December 31, 2004, we agreed to certain representations and warranties associated with the disposition of our funeral operation in France. The fair value of the representations and warranties associated with the sale was approximately $33 million and included indemnifications related to taxes and other obligations at December 31, 2004. This amount is recorded in *Other liabilities* in our consolidated balance sheet.

Preneed Funeral and Cemetery Activities

In addition to selling our products and services to client families at the time of need, we believe an active funeral and cemetery preneed program, which complements our framework for long-term growth, can increase future market share in our service markets. Preneed arrangement is a means through which a customer contractually agrees to the terms of a funeral service, cremation service, and/or cemetery burial interment right, merchandise or cemetery service to be performed or provided in the future (that is, in advance of when needed or preneed).

Preneed Funeral Activities

Since preneed funeral services or merchandise will not be provided until some time in the future, most states and provinces require that all or a portion of the funds collected from customers on preneed funeral contracts be protected for the benefit of the customer pursuant to state or provincial law. Some or all of the funds may be required to be placed into trust accounts, or a surety bond may be posted in lieu of trusting (collectively trust funded preneed funeral contracts). Alternatively, where allowed, customers may choose to purchase a life insurance or annuity policy from third party insurance companies to fund their preneed funeral (insurance funded preneed funeral contract). Only certain of these customer funding options may be applicable in any given market we serve.

The contract amounts associated with unfulfilled insurance funded preneed funeral contracts are not reflected on our consolidated balance sheet. However, when customers enter into a trust funded preneed contract, we record an asset, *Preneed funeral receivables and trust investments* and a corresponding obligation, *Deferred preneed funeral revenues* in our consolidated balance sheet for the contract price. The preneed funeral receivable is then decreased by the cash received from the customer at the time of sale. The funeral revenues are deferred and will not be recognized in the consolidated statement of operations until the funeral services are performed or the merchandise is delivered. When we receive payments on a trust funded preneed funeral contract from the customer, we deposit the amount required by law into the trust and reclass the corresponding amount from *Deferred preneed funeral revenues* into *Non-controlling interest in funeral and cemetery trusts*. While some customers may pay for their contract in a single payment, most preneed funerals are sold on an installment basis over a period of one to seven years. On these installment contracts, we receive, on average, a down payment at the time of sale of approximately 10%. Historically, the majority of our preneed funeral trust contracts have not included a finance charge. However, we began test marketing of a finance charge program for preneed funeral trust contracts during the fourth quarter of 2004. We may plan a phased rollout during 2005 to the states where such finance charges are allowed.

Table of Contents

Trust Funded Preneed Funeral Contracts: Where the state or provincial law requires that all or a portion of the funds collected from preneed funeral contracts be placed in trust accounts, the funds deposited into trust are invested by the independent trustees in accordance with the investment guidelines established by statute or, where the prudent investor rule is applicable, the guidelines established by the Investment Committee of our Board of Directors. The trustees utilize professional investment advisors to select and monitor the money managers that make the individual investment decisions in accordance with the guidelines. We retain any funds above the amounts required to be deposited into trust accounts and use them for working capital purposes, generally to offset the selling and administrative costs of the preneed programs. State or provincial law governs the timing of the required deposits into the trust accounts, which generally ranges from five to 45 days after receipt of the funds from the customer.

The trust investments are expected to generate earnings sufficient to offset the inflationary costs of providing the preneed funeral services and merchandise in the future for the prices that were guaranteed at the time of sale. As a result of the adoption of FIN 46R, the preneed funeral trust assets have been consolidated and are recorded in our consolidated balance sheet at market value in accordance with SFAS 115. Investment earnings on trust assets are generally accumulated in the trust and distributed as each preneed contract is either utilized upon the death of, or cancelled by, the customer. However, in certain states, the trusts are allowed to distribute a portion of the investment earnings to us prior to that date. See the Critical Accounting Policies and Accounting Changes of Item 2 of this Form 10-K/A (Amendment No. 2) for additional information regarding the implementation of FIN 46R.

Direct selling costs (which consist of direct compensation costs and related payroll expenses directly attributable to selling preneed funeral trust funded contracts) incurred pursuant to the sales of trust funded preneed funeral contracts are deferred and included in *Deferred charges and other assets* in the consolidated balance sheet. The deferred selling costs are expensed in proportion to the corresponding trust funded preneed funeral contract revenues when recognized. Other selling costs associated with the sales and marketing of preneed funeral contracts (e.g., lead procurements costs, brochures and marketing materials, advertising and administrative costs) are expensed as incurred. An allowance for cancellation is recorded for trust funded preneed funeral contract deferred selling costs based on historical contract cancellation experience.

If a customer cancels the trust funded preneed funeral contract, state or provincial law determines the amount of the refund owed to the customer, including in certain situations the amount of the attributed investment earnings. Upon cancellation, we receive the amount of principal deposited to trust and previously undistributed net investment earnings and pay the customer the required refund. We retain any excess funds and recognize the amounts as funeral revenues in our consolidated statement of operations. In certain jurisdictions, we may be obligated to fund any shortfall if the amounts deposited by the customer exceed the funds in trust. As a result, when realized or unrealized losses of a trust result in trust funded preneed funeral contracts being under-funded, we will assess those contracts to determine whether a loss provision should be recorded. We have not been required to recognize any loss amounts at December 31, 2004, 2003 or 2002.

The cash flow activity over the life of a trust funded preneed funeral contract from the date of sale to its death maturity or cancellation is captured in the line item *Net effect of preneed funeral production and maturities* in the consolidated statement of cash flows. While the contract is outstanding, cash flow is provided by the amount retained from funds collected from the customer and any distributed investment earnings. This is reduced by the payment of trust funded preneed funeral deferred selling costs. The effect of amortizing trust funded preneed funeral deferred selling costs is reflected in *Depreciation and amortization* in the consolidated statement of cash flows. At the time of death maturity, we receive the principal and undistributed investment earnings from the trust and any remaining receivable due from the customer. This cash flow at the time of service is generally less than the revenue recognized, thus creating a negative effect on working capital cash flow from operating activities.

In certain situations pursuant to state or provincial laws, we can post a surety bond as financial assurance for an amount that would otherwise be required to be deposited in trust accounts for trust funded preneed funeral contracts. See the *Financial Assurances* section within this Preneed Funeral and Cemetery Activities section for further details on our practice of posting such surety bonds. We believe the deferred revenues associated with preneed funeral bonded contracts exceed the expected cost of meeting our obligations to provide funeral services and merchandise for the outstanding preneed funeral bonded contracts, and our future operating cash flows will be sufficient to fulfill these contracts without use of the surety bonds. If the expected costs were to exceed the deferred revenues, we would be required to record a loss provision in our consolidated statement of operations.

If a customer cancels the trust funded preneed funeral contract that has been bonded prior to death maturity, state or provincial law determines the amount of the refund owed to the customer. Because the funds have not been held in trust, there are no earnings to be refunded to the customer or us. We pay the customer refund out of our operating funds, which reduces working capital cash flow from operating activities.

The cash flow activity over the life of a preneed funeral contract that has been bonded from the date of sale to its death maturity or cancellation is captured in the line item *Net effect of preneed funeral production and maturities* in the consolidated statement of cash flows. The payments received from our customers for their trust funded preneed funeral contracts that have been bonded are a source of working capital cash flow from operating activities until the contracts mature. This is reduced by the payment of deferred selling costs, the premiums to the surety companies for the bond coverage, and refunds on customer cancellations of contracts. When a trust funded preneed funeral contract that has been bonded matures upon the death of the beneficiary, there is no additional cash flow to us (unless the customer owed an outstanding balance), thus creating a negative effect on the cash flow from operating activities.

Insurance Funded Preneed Funeral Contracts: Where permitted, customers arrange their funeral contract by purchasing a life insurance or annuity policy from third party insurance companies, for which we earn a commission for being the general agent for the insurance company. The policy amount of the insurance contract between the customer and the third party insurance company generally equals the amount of the preneed funeral contract. However, we do not reflect the unfulfilled insurance funded preneed funeral contract amounts in our consolidated balance sheet.

The third party insurance company collects funds related to the insurance contract directly from the customer. The life insurance contracts include increasing death benefit provisions, which are expected to offset the inflationary costs of providing the preneed funeral services and merchandise in the future for the prices that were guaranteed at the time of the preneed sale. Increasing insurance benefits or death benefits payable by third party insurance companies increase annually pursuant to the terms of the life insurance policies purchased in advance of need by our customers to fund their funerals. The customer/policy holder assigns the policy benefits to our funeral home to pay for the preneed funeral contract at the time of need. Approximately 68% of our 2004 North America preneed funeral production is insurance funded preneed funeral contracts.

We receive general agency commissions from third party insurance companies when customers purchase insurance contracts from such third party insurance companies to fund funeral services and merchandise at a future date. These general agency commissions are based on a percentage per contract sold and are recognized as funeral revenues when the insurance purchase transaction between the customer and third party insurance provider is completed. Direct selling costs incurred pursuant to the sale of insurance funded preneed funeral contracts are expensed as incurred.

Additionally, we may receive cash overrides based on achieving certain dollar volume targets of life insurance policies sold as a result of marketing agreements entered into in connection with the sale of our insurance subsidiaries in 2000. These overrides are recorded in *Other income, net* in the consolidated statement of operations.

If a customer cancels the insurance funded preneed funeral contract prior to death maturity, the insurance company pays the cash surrender value under the insurance policy directly to the customer. If the contract was outstanding for less than one year, the insurance company charges back the GA revenues and overrides we received on the contract. An allowance for these chargebacks is included in the consolidated balance sheet based on our historical chargeback experience.

Because insurance funded preneed funeral contracts are not reflected in our consolidated balance sheet, the cash flow activity associated with these contracts generally occurs only at the time of sale and at death maturity or cancellation and is recorded as cash flows from operating activities within our funeral segment. At the time of sale, the GA revenues and overrides received net of the direct selling costs provide a net source of cash flow. If the insurance contract cancels within one year following the date of sale, our cash flow is reduced by the chargeback of GA revenues and overrides. At death maturity, the insurance funded preneed funeral contracts are included in funeral trade accounts receivable and funeral revenues when the funeral service is performed. Proceeds from the life insurance policies are used to satisfy the receivables due. The insurance proceeds (which include the increasing death benefit) less the funds used to provide the funeral goods and services provide a net source of cash flow.

The table below details the North America results of trust and insurance funded preneed funeral production for the twelve months ended December 31, 2004 and 2003, the number of contracts associated with that net production, the related deferred selling costs incurred to obtain the trust funded preneed arrangements, and the net selling activity associated with insurance funded preneed arrangements included in our consolidated statement of operations. The decline in GA revenue is a result of a shift in product mix from whole life policies to flex insurance policies, for which we earn a lower commission rate. The increase in direct expenses is the result of higher fringe benefits expenses and shifts in the product mix by counselor between trust and insurance. Additionally, the table reflects revenues and previously deferred trust funded preneed funeral contract selling costs recognized in the consolidated statement of operations associated with death maturities of preneed funeral contracts for the year ended December 31, 2004 and

2003.

Table of Contents

	North America Funeral Twelve months ended December 31,	
(Dollars in millions)	**2004**	**2003**
	(Restated)	(Restated)
Preneed Production:		
Trust (including bonded)	$ 113.9	$ 99.7
Insurance (1)	238.6	237.7
Total	$ 352.5	$ 337.4
Preneed Production (number of contracts):		
Trust (including bonded)	33,286	30,107
Insurance (1)	51,533	54,622
Total	84,819	84,729
Trust funded preneed funeral deferred selling costs	$ 15.1	$ 13.4
Insurance funded preneed funeral selling activity:		
GA revenue	$ 28.3	$ 27.7
Direct expenses	26.7	23.9
Net activity	$ 1.6	$ 3.8
Death Maturity:		
Previous preneed production included in current period revenues:		
Trust	$ 161.7	$ 173.7
Insurance	197.2	165.8
	$ 358.9	$ 339.5
Amortization/recognition of trust funded preneed funeral deferred selling costs in current period	$ 9.3	$ 9.2

(1) Amounts are not included in the consolidated balance sheet.

The following table reflects the North America backlog of trust funded deferred preneed funeral contract revenues (market and cost basis) including amounts related to *Non-controlling interest in funeral and cemetery trusts* at

December 31, 2004 and 2003. Additionally, we have reflected the North American backlog of unfulfilled insurance funded contracts (not included in our consolidated balance sheet) and total North American backlog of preneed funeral contract revenues at December 31, 2004 and 2003. The backlog amounts presented are reduced by an amount that we believe will cancel before maturity.

The table also reflects the North America trust funded preneed funeral receivables and trust investments (investments at market and cost basis) associated with the backlog of trust funded deferred preneed funeral contract revenues, net of an estimated cancellation allowance. The difference between the backlog and asset amounts represents the contracts for which we have posted surety bonds as financial assurance in lieu of trusting and the amounts collected from customers that were not required to be deposited to trust. The table also reflects the amounts expected to be received from insurance companies from the assignment of policy proceeds related to insurance funded contracts. The preneed funeral deferred selling costs associated with trust funded contracts (net of an estimated allowance for cancellation) are included with preneed cemetery deferred selling costs as a component of *Deferred charges and other assets*.

Table of Contents

	North America Funeral			
	2004 (Restated)		2003 (Restated)	
(Dollars in millions)	**Market**	**Cost**	**Market**	**Cost**
Backlog of trust funded deferred preneed funeral revenues (1)	$ 1,475.9	$ 1,440.8	$ 1,491.4	$ 1,474.3
Backlog of insurance funded preneed funeral revenues (2)	$ 2,202.6	$ 2,202.6	$ 2,018.4	$ 2,018.4
Total backlog of preneed funeral revenues	$ 3,678.5	$ 3,643.4	$ 3,509.8	$ 3,492.7
Assets associated with backlog of trust funded deferred preneed funeral revenues, net of estimated allowance for cancellation	$ 1,165.8	$ 1,130.6	$ 1,146.0	$ 1,128.9
Insurance policies associated with insurance funded deferred preneed funeral revenues, net of estimated allowance for cancellation(2)	$ 2,202.6	$ 2,202.6	$ 2,018.4	$ 2,018.4
Total assets associated with backlog of preneed funeral revenues	$ 3,368.4	$ 3,333.2	$ 3,164.4	$ 3,147.3
Deferred selling costs associated with trust funded deferred preneed funeral revenues		$ 99.4		$ 95.4