

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

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

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2005

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the transition period from _____ to _____
Commission file number 1-6402-1

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

Texas
(State or other jurisdiction of
incorporation or organization)

74-1488375
(I. R. S. employer identification
number)

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

77019
(Zip code)

713-522-5141
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to the filing requirements for the past 90 days.

YES

NO

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

YES

NO

The number of shares outstanding of the registrant's common stock as of May 1, 2005 was 309,367,376 (net of treasury shares).

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Explanatory Note:

The Company has amended its March 31, 2005 Form 10-Q filed May 16, 2005 to restate its condensed consolidated statement of operations and consolidated statement of cash flows for the three months ended March 31, 2005 and 2004, and its condensed consolidated balance sheet at March 31, 2005 and December 31, 2004. Included in this Form 10-Q/A (Amendment No. 1) 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, (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, and a loss on a property disposition recorded in April 2005 which should have been recognized in the Company's first quarter 2005 condensed consolidated financial statements, and (4) the accrual of a dividend. All applicable amounts relating to this restatement have been reflected in the condensed consolidated financial statements and disclosed in the notes to the condensed consolidated financial statements in this Form 10-Q/A (Amendment No. 1).

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SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

(In thousands, except per share amounts)

	Three months ended	
	March 31,	
	2005	2004
	(Restated)	(Restated)
	note 2	note 2
Revenues	\$ 454,871	\$ 588,699
Costs and expenses	355,097	473,070
Gross profit	99,774	115,629
General and administrative expenses	(19,716)	(51,021)
Gains and impairment (losses) on dispositions, net	(5,741)	34,785
Operating income	74,317	99,393
Interest expense	(24,656)	(32,658)
Loss on early extinguishment of debt	(1,207)	
Other income, net	2,687	6,424
	(23,176)	(26,234)
Income from continuing operations before income taxes and cumulative effects of accounting changes	51,141	73,159
Provision (benefit) for income taxes	17,899	(3,779)
Income from continuing operations before cumulative effects of accounting changes	33,242	76,938
(Loss) income from discontinued operations (net of income tax provision of \$594 and \$141, respectively)	(650)	754
Cumulative effects of accounting changes (net of income tax benefit of \$117,428 and \$20,983, respectively)	(187,538)	(47,556)
Net (loss) income	\$ (154,946)	\$ 30,136
Basic earnings (loss) per share:		
Income from continuing operations before cumulative effects of accounting changes	\$.11	\$.25
(Loss) income from discontinued operations, net of tax		
Cumulative effects of accounting changes, net of tax	(.60)	(.15)

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Net (loss) income	\$	(.49)	\$.10
Diluted earnings (loss) per share:				
Income from continuing operations before cumulative effects of accounting changes		.10		.23
(Loss) income from discontinued operations, net of tax				
Cumulative effects of accounting changes, net of tax		(.59)		(.13)
Net (loss) income	\$	(.49)	\$.10
Basic weighted average number of shares		313,490		303,018
Diluted weighted average number of shares		317,751		353,088
Dividends declared per share	\$.025	\$	

(See notes to unaudited condensed consolidated financial statements)

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

	March 31, 2005 (Restated) note 2	December 31, 2004 (Restated) note 2
Assets		
Current assets:		
Cash and cash equivalents	\$ 320,493	\$ 287,785
Receivables, net	102,515	102,622
Inventories	85,761	81,526
Current assets of discontinued operations		11,085
Other	34,510	50,945
Total current assets	543,279	533,963
Preneed funeral receivables and trust investments	1,245,726	1,267,784
Preneed cemetery receivables and trust investments	1,362,276	1,399,778
Cemetery property, at cost	1,505,842	1,509,599
Property and equipment, at cost, net	966,627	970,547
Non-current assets of discontinued operations		4,367
Deferred charges and other assets	299,201	621,561
Goodwill	1,162,215	1,169,040
Cemetery perpetual care trust investments	706,585	729,048
Total assets	\$ 7,791,751	\$ 8,205,687
Liabilities & Stockholders Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 231,403	\$ 221,877
Current maturities of long-term debt	75,936	75,075
Current liabilities of discontinued operations		7,111
Income taxes	4,152	7,850
Total current liabilities	311,491	311,913
Long-term debt	1,172,139	1,178,885
Deferred preneed funeral revenues	500,943	498,571
Deferred preneed cemetery revenues	813,149	803,144
Deferred income taxes	191,204	276,572
Non-current liabilities of discontinued operations		58,225
Other liabilities	421,068	431,917
Non-controlling interest in funeral and cemetery trusts	2,042,933	2,092,881
Commitments and contingencies (note 9)		

Non-controlling interest in perpetual care trusts	685,716	704,912
Stockholders' equity:		
Common stock, \$1 per share par value, 500,000,000 shares authorized, 310,009,494 and 323,225,352, issued and outstanding (net of 32,653,741 and 18,502,478 treasury shares, at par)	310,009	323,225
Capital in excess of par value	2,305,588	2,395,057
Unearned compensation	(5,251)	(2,022)
Accumulated deficit	(984,190)	(829,244)
Accumulated other comprehensive income (loss)	26,952	(38,349)
Total stockholders' equity	1,653,108	1,848,667
Total liabilities and stockholders' equity	\$ 7,791,751	\$ 8,205,687

(See notes to unaudited condensed consolidated financial statements)

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

	Three months ended	
	March 31,	
	2005	2004
	(Restated)	(Restated)
	note 2	note 2
Cash flows from operating activities:		
Net (loss) income	\$ (154,946)	\$ 30,136
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Net loss (income) from discontinued operations	650	(754)
Loss on early extinguishment of debt	1,207	
Cumulative effects of accounting changes, net of tax	187,538	47,556
Depreciation and amortization	21,089	36,327
Provision (benefit) for deferred income taxes	16,313	(5,019)
(Gains) and impairment losses on dispositions, net	5,741	(34,785)
Other non-cash adjustments	(1,950)	224
Change in assets and liabilities, net of effects from acquisitions and dispositions:		
(Increase) decrease in receivables	(5,548)	7,172
Decrease in other assets	29,031	2,836
(Decrease) increase in payables and other liabilities	(6,322)	5,667
Net effect of preneed funeral production and maturities	12,470	(11,078)
Net effect of cemetery production and deliveries	22,475	4,635
Other	101	4,460
Net cash provided by operating activities from continuing operations	127,849	87,377
Net cash (used in) provided by operating activities from discontinued operations	(241)	1,267
Net cash provided by operating activities	127,608	88,644
Cash flows from investing activities:		
Capital expenditures	(20,613)	(17,698)
Proceeds from divestitures and sales of property and equipment	8,236	8,744
Proceeds and distributions from dispositions of businesses, net of cash retained	21,597	287,886
Indemnity payments related to the joint venture of French operations	(772)	
Net withdrawals (deposits) of restricted funds and other	6,961	(105,601)
Net cash provided by investing activities from continuing operations	15,409	173,331
Net cash used in investing activities from discontinued operations		(39)
Net cash provided by investing activities	15,409	173,292
Cash flows from financing activities:		
Payments of debt	(1,974)	(5,907)

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Early extinguishments of debt	(7,673)	
Proceeds from exercise of stock options	3,904	3,294
Purchase of Company common stock	(103,570)	
Purchase of subsidiary stock	(844)	
Net cash used in financing activities	(110,157)	(2,613)
Effect of foreign currency	(152)	157
Net increase in cash and cash equivalents	32,708	259,480
Cash and cash equivalents at beginning of period	287,785	239,431
Cash and cash equivalents at end of period	\$ 320,493	\$ 498,911

(See notes to unaudited condensed consolidated financial statements)

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

	Outstanding	Common	Treasury stock, par value	Capital in excess of par value (Restated) note 2	Unearned Compensation (Restated) note 2	Accumulated deficit (Restated) note 2	Accumulated other comprehensive income (loss) (Restated) note 2	Total (Restated) note 2
Balance at December 31, 2004	323,225	\$ 341,727	\$ (18,502)	\$ 2,395,057	\$ (2,022)	\$ (829,244)	\$ (38,349)	\$ 1,848,667
Net loss						(154,946)		(154,946)
Dividends on common stock (\$0.025 per share)				(7,734)				(7,734)
Other comprehensive income: Foreign currency translation Reclassification for translation adjustments realized in net loss							(6,469)	(6,469)
							71,770	71,770
Total other comprehensive income								65,301
Tax benefit from stock option exercises				1,034				1,034
Stock option exercises and other	936	936		2,973				3,909
Restricted stock award	499		499	3,177	(3,676)			
Restricted stock amortization					447			447

Purchase of Company common stock	(14,651)		(14,651)	(88,919)				(103,570)
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Balance at March 31, 2005	310,009	\$ 342,663	\$ (32,654)	\$ 2,305,588	\$ (5,251)	\$ (984,190)	\$ 26,952	\$ 1,653,108
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(See notes to unaudited condensed consolidated financial statements)

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

1. Nature of Operations

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

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

2. Restatement of Financial Statements

Overview

The Company has restated herein its previously issued consolidated statement of operations and consolidated statement of cash flows for the three months ended March 31, 2005 and 2004, and its consolidated balance sheet at March 31, 2005 and December 31, 2004. This restatement corrects 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, (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, and a loss on a property disposition recorded in April 2005 which should have been recognized in the Company's first quarter 2005 condensed consolidated financial statements, and (4) the accrual of a dividend. All applicable amounts relating to this restatement have been reflected in the Company's condensed consolidated financial statements and disclosed in the notes to the consolidated financial statements in this Form 10-Q/A (Amendment No. 1).

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

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However, in light of the material impact of the errors identified in the second quarter of 2005, as detailed below under *Current Period Restatement*, the Company has concluded that prior period financial statements for the fiscal years ended 2004, 2003 and 2002 should be restated and has corrected such prior periods for the \$416 net impact to *Other operating (expense) income* described above. Please refer to the Company's 2004 Form 10-K/A (Amendment No. 2) for details related to the impacts of this restatement on the Company's consolidated statements for each of the five years ended December 31, 2004; all four interim periods of 2004; and all four interim periods of 2003.

Current Period Restatement*Preneed Funeral and Cemetery Trust Verification and Reconciliation Project*

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

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

As these projects progressed, the Company assessed their status and adjusted the applicable general ledger accounts accordingly. At December 31, 2003, June 30, 2004, and December 31, 2004, the Company made certain adjustments to its consolidated financial statements based on its best estimates at that time. These adjustments were based on statistical sampling methods which were influenced by the percentage of reconciliations and verifications completed at the location level and the expected error rate of such uncompleted verifications and reconciliations. Please see the Company's 2004 Form 10-K/A (Amendment No. 2) for additional information related to the history of these projects.

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

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

Also during the second quarter of 2005, the Company identified other adjustments, one of which related to a point-of-sale system error that caused preneed funeral trust income accounts to be understated in the fourth quarter of 2004 and the first quarter of 2005 by \$1,570 and \$2,700, respectively, and another of which related to the

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recognition of a loss on a disposition recorded in April 2005 that should have been recognized in the Company's first quarter 2005 unaudited consolidated financial statements. In connection with the asset divestitures, the Company did not write off certain covenant-not-to-compete agreements, which should have been recorded in the Company's 2002 consolidated financial statements.

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

Materiality Assessment

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

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As discussed above, the quarterly financial statements for the three months ended March 31, 2004 have been further restated in connection with this restatement. We have also reflected the effects of this restatement in notes four, seven, eight, ten, eleven, and twelve. The effect of these adjustments to the Company's consolidated statement of operations for the first quarter of both 2005 and 2004 is detailed below.

	Three months ended March 31, 2005	
	As Reported	As Restated
	Revenues	\$ 452,923
Costs and expenses	355,136	355,097
Gross profits	97,787	99,774
Gains and impairment (losses) on dispositions, net	(3,962)	(5,741)
Operating income	72,509	74,317
Income from continuing operations before income taxes and cumulative effects of accounting changes	49,333	51,141
Provision for income taxes	17,266	17,899
Cumulative effects of accounting changes	(187,538)	(187,538)
Net loss	\$(156,121)	\$(154,946)
Loss per share:		
Basic EPS	\$ (.50)	\$ (.49)
Diluted EPS	\$ (.49)	\$ (.49)

	Three months ended March 31, 2004	
	As Reported	As Restated
	Revenues	\$589,422
Costs and expenses	473,109	473,070
Gross profits	116,313	115,629
Gains and impairment (losses) on dispositions, net	34,782	34,785
Operating income	100,490	99,393
Income from continuing operations before income taxes and cumulative effects of accounting changes	74,256	73,159
Benefit for income taxes	(3,375)	(3,779)
Cumulative effects of accounting changes	(47,074)	(47,556)
Net income	\$ 31,311	\$ 30,136
Earnings per share:		
Basic EPS	\$.10	\$.10
Diluted EPS	\$.10	\$.10

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

	March 31, 2005		December 31, 2004	
	As Reported	As Restated	As Reported	As Restated
Selected consolidated balance sheet data:				
Receivables, net of allowances	\$ 102,002	\$ 102,515	\$ 102,156	\$ 102,622
Total current assets	543,317	543,279	533,497	533,963
Preneed funeral receivables and trust investments	1,236,538	1,245,726	1,264,600	1,267,784
Preneed cemetery receivables and trust investments	1,368,451	1,362,276	1,402,750	1,399,778
Deferred charges and other assets	295,789	299,201	618,565	621,561
Total assets	7,783,879	7,791,751	8,199,196	8,205,687
Deferred preneed funeral revenues	492,455	500,943	486,191	498,571
Deferred preneed cemetery revenues	809,581	813,149	801,065	803,144
Deferred income taxes	193,473	191,204	279,474	276,572
Non-controlling interest in funeral and cemetery trusts	2,042,879	2,042,933	2,095,852	2,092,881
Accumulated deficit	980,485	984,190	824,364	829,244
Total stockholders' equity	1,664,572	1,653,108	1,853,576	1,848,667
Total liabilities and stockholders' equity	7,783,879	7,791,751	8,199,196	8,205,687

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3. Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

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

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

Use of Estimates in the Preparation of Financial Statements

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

The effective tax rate in the three months ended March 31, 2005 was an expense of 35.0% compared to a benefit of 5.2% in the three months ended March 31, 2004. The 2004 rate was favorably impacted by non-cash tax benefits realized from the joint venture of the Company's French operations consummated in March 2004. For more information regarding the sale of the Company's French funeral operations, see note twelve to the consolidated financial statements.

4. Accounting Changes and New Accounting Pronouncements

Deferred Selling Costs

Effective January 1, 2005, the Company changed its method of accounting for direct selling costs related to the acquisition of preneed funeral and preneed cemetery contracts. Prior to this change, the Company capitalized such direct selling costs and amortized these

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deferred selling costs in proportion to the revenue recognized. Under the new method of accounting, the Company expenses these direct selling costs as incurred. The Company believes the new method is preferable because it better reflects the economics of the Company's business.

As of January 1, 2005, the Company recorded a cumulative effect of \$187,538, net of tax of \$117,428. This amount represents the cumulative balance of deferred selling costs recorded on the Company's consolidated balance sheet in *Deferred charges and other assets* at the time of the accounting change. If the Company had not changed its method of accounting for direct selling costs as described above, net income for the first quarter of 2005 would have been \$2,296 after tax or \$.01 per basic and diluted share higher than currently reported.

The three months ended March 31, 2004 pro forma amounts in the table below reflect the new policy to expense selling costs as incurred. The effect of the change for the quarter ended March 31, 2004 would have decreased net income from continuing operations before cumulative effects of accounting changes by approximately \$2,848 after tax or \$.01 per basic and diluted share.

	Three months ended March 31, 2004		
	Historical	Deferred	Pro forma
	(Restated)	Selling	(Restated)
	note 2	Costs, net (1)	note 2
Gross profits:			
Funeral	\$ 86,559	\$ (487)	\$ 86,072
Cemetery	29,070	(3,894)	25,176
	115,629	(4,381)	111,248
Income (loss) from continuing operations before income taxes and cumulative effects of accounting changes	\$ 73,159	\$ (4,381)	\$ 68,778
Net income (loss)	\$ 30,136	\$ (2,848)	\$ 27,288
Amounts per common share:			
Net income (loss) basic	\$.10	\$ (.01)	\$.09
Net income (loss) diluted	\$.10	\$ (.01)	\$.09

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

Other Than Temporary Impairments

In March 2004, the FASB reached consensus on the guidance provided by Emerging Issues Task Force Issue 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* (EITF 03-1). 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* (SFAS 115). 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. The Company 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 the consolidated financial statements, results of operations, financial position, or cash flows of the Company.

Table of Contents*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 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect this statement to have a material impact on its consolidated financial statements, results of operations, financial position, or cash flows.

Income Taxes

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. The Company has adopted the provisions of FAS 109-2. The Company is in the process of evaluating whether it 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. The Company estimates the range of possible amounts of unremitted earnings under consideration is between \$0 and \$2,276. If the maximum amount of \$2,276 were to be repatriated, the Company would accrue tax expense of approximately \$434.

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 Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. Among other items, SFAS 123R eliminates the use of the intrinsic value method of accounting, and requires companies to recognize the cost of employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements. The effective date of SFAS 123R is the first annual reporting period beginning after June 15, 2005, which is the first quarter of 2006 for the Company.

For disclosure purposes, the Company currently utilizes a standard option pricing model (i.e., Black-Scholes) to measure the fair value of stock options granted to employees. While SFAS 123R permits entities to continue to use such a model, the standard also permits the use of a lattice model. The Company will continue to utilize the Black-Scholes option pricing model to measure the fair value of its stock options.

The Company expects to adopt SFAS 123R effective January 1, 2006. The Company is currently evaluating the impact that the adoption will have on the Company's results of operations.

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, the Company is required to consolidate certain cemeteries and trust assets. Merchandise and service trusts and cemetery perpetual care trusts are considered variable interest entities because the trusts meet the conditions of paragraphs 5(a) and 5(b)(1) of FIN 46R. That is, as a group, the equity investors (if any) do not have sufficient equity at risk and do not have the direct or indirect ability through voting or similar rights to make decisions about the trusts' activities that have a

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significant effect on the success of the trusts. FIN 46R required the Company to consolidate merchandise and service trusts and cemetery perpetual care trusts for which the Company is the primary beneficiary (i.e., those for which the Company absorbs a majority of the trusts' expected losses). The Company is the primary beneficiary of a trust whenever a majority of the assets of the trust are attributable to deposits of customers of the Company.

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

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

The Company records cash received from customers that is payable to the trusts but not yet required to be deposited in the trusts as restricted cash in *Deferred charges and other assets* in its consolidated balance sheet. At March 31, 2005 and December 31, 2004, these pending deposits totaled \$13,430 and \$11,218, respectively. The Company continues to account for amounts received from customers prior to delivery of merchandise or services that are not required to be deposited in merchandise and service trusts as deferred revenue.

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

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

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

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

Both the merchandise and services trusts and the cemetery perpetual care trusts hold investments in marketable securities that are classified as available-for-sale by the Company under the requirements of 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 income (loss)* in the Company's consolidated balance sheet. Using the guidance in EITF Topic D-41, *Adjustments in Assets and Liabilities for Holding Gains and Losses as Related to the Implementation of FASB Statement No. 115* (Topic D-41), unrealized gains and losses on available-for-sale securities of the trusts attributable to the non-controlling interest holders are not recorded as *Accumulated other comprehensive income (loss)*, but are recorded as an adjustment to either *Non-controlling interest in funeral and cemetery trusts* or *Non-controlling interest in perpetual care trusts*. Therefore, unrealized gains and losses attributable to the non-controlling interest holders are reclassified from *Accumulated other comprehensive income (loss)* to either *Non-controlling interest in funeral and cemetery trusts* or *Non-controlling interest in perpetual care trusts*. The gross effect from applying Topic D-41 on the Company's *Accumulated other comprehensive income (loss)* is disclosed in note eleven of the consolidated financial statements. However, the Company's *Accumulated other comprehensive income (loss)* balance on the face of the balance sheet is ultimately not affected by consolidation of the trusts.

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

Pension Plans

Effective January 1, 2004, the Company changed its accounting for gains and losses on its pension plan assets and obligations. The Company now recognizes such gains and losses in its consolidated statement of operations as such gains and losses are incurred. Prior to January 1, 2004, the Company amortized the difference between actual and expected investment returns and actuarial gains and losses over seven years (except to the extent that settlements with employees required earlier recognition). The Company believes the new method of accounting better reflects the economic nature of the Company's pension plans and recognizes gains and losses on the pension plan assets and liabilities in the year the gains or losses occur. As a result of this accounting change, the Company recognized a charge for the cumulative effect of an accounting change of \$33,599 (net of tax) as of January 1, 2004. This amount represents accumulated unrecognized net losses related to the pension plan assets and liabilities. In addition, for interim periods, the Company records net pension expense or income reflecting estimated returns on plan assets and obligations. The Company will recognize actual gains and losses on plan assets and obligations as actuarial information becomes available upon review of the annual rereasurement.

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Debt was as follows:

	March 31, 2005	December 31, 2004
6.0% notes due December 2005	\$ 63,801	\$ 63,801
7.2% notes due June 2006	150,000	150,000
6.875% notes due October 2007	143,475	143,475
6.5% notes due March 2008	195,000	195,000
7.7% notes due April 2009	351,135	358,266
7.875% debentures due February 2013	55,627	55,627
6.75% notes due April 2016	250,000	250,000
Convertible debentures, maturities through 2013, fixed interest rates from 4.75% to 5.5%, conversion prices from \$13.02 to \$50.00 per share	30,841	30,853
Mortgage notes and other debt, maturities through 2050	46,232	48,194
Deferred charges	(38,036)	(41,256)
Total debt	1,248,075	1,253,960
Less current maturities	(75,936)	(75,075)
Total long-term debt	\$ 1,172,139	\$ 1,178,885

The Company's consolidated debt had a weighted average interest rate of 7.02% at March 31, 2005 and December 31, 2004. Approximately 99% of the total debt had a fixed interest rate at March 31, 2005 and December 31, 2004.

Bank Credit Agreements

The Company's bank credit agreement, which was executed on August 11, 2004 and matures in August of 2007, provides a total lending commitment of \$200,000, including a sublimit of \$175,000 for letters of credit. As of March 31, 2005, the Company has no cash borrowings under this credit facility, but has used it to support \$62,042 of letters of credit. The new bank credit facility provides the Company with flexibility in terms of acquisitions, dividends and share repurchases. It is secured by the stock of the Company's domestic subsidiaries and these domestic subsidiaries have guaranteed the Company's indebtedness associated with this facility. The subsidiary guarantee is a guarantee of payment of the outstanding amount of the total lending commitment. It covers the term of the agreement, including extensions and totaled a maximum potential amount of \$62,042 and \$66,985 at March 31, 2005 and December 31, 2004, respectively. The facility contains certain financial covenants, including a minimum interest coverage ratio, a maximum leverage ratio, maximum capital expenditure limitations, minimum net worth requirements and certain cash distribution restrictions. Interest rates for the outstanding borrowings will be based on various indices as determined by the Company. The Company also pays a quarterly fee on the unused commitment, which ranges from 0.25% to 0.50%.

Debt Extinguishments and Reductions

In the first quarter of 2005, the Company purchased \$7,131 aggregate principal amount of its 7.70% notes due 2009 in the open market. As a result of this transaction, the Company recognized a loss of \$1,207 recorded in *Loss on early extinguishment of debt*, in the consolidated statement of operations.

In March 2004, in connection with the sale of the Company's funeral operations in France, mortgage notes and other debt was reduced by approximately \$24,194 for capital lease obligations related to vehicles used in the French funeral operations.

Additional Debt Disclosures

At March 31, 2005 and December 31, 2004, the Company had deposited \$14,638 and \$26,707, respectively, in restricted, interest-bearing accounts that were pledged as collateral for various credit instruments and commercial commitments. They are included in *Deferred charges and other assets* in the consolidated balance sheet.

Table of Contents**6. Retirement Plans**

The components of net periodic pension plan benefit cost for the three months ended March 31 were as follows:

	Three months ended March 31,	
	2005	2004
Service cost – benefits earned during the period	\$ 2,015	\$ 2,245
Interest cost on projected benefit obligation	(1,202)	(1,790)
Return on plan assets	46	45
Amortization of prior service cost	\$ 859	\$ 500

7. Segment Reporting

The Company's operations are both product based and geographically based, and the reportable operating segments presented below include the Company's funeral and cemetery operations. The Company's geographic areas include North America and Other Foreign. In 2005, Other Foreign consists of the Company's operations in Singapore, Germany and South America. In 2004, Other Foreign also included operations in France, which were disposed of in the first quarter of 2004. The Company conducts both funeral and cemetery operations in the North America and Other Foreign geographic areas.

The Company's reportable segment information is as follows:

	Funeral	Cemetery	Reportable segments
Revenues from external customers:			
Three months ended March 31,			
2005 (Restated – note 2)	\$ 319,451	\$ 135,420	\$ 454,871
2004 (Restated – note 2)	\$ 434,521	\$ 154,178	\$ 588,699
Gross profit:			
Three months ended March 31,			
2005 (Restated – note 2)	\$ 79,622	\$ 20,152	\$ 99,774
2004 (Restated – note 2)	\$ 86,559	\$ 29,070	\$ 115,629

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

	Three months ended March 31,	
	2005 (Restated) note 2	2004 (Restated) note 2
Gross profit from reportable segments	\$ 99,774	\$ 115,629
General and administrative expenses	(19,716)	(51,021)
Gains and impairment (losses) on dispositions, net	(5,741)	34,785
Operating income	74,317	99,393
Interest expense	(24,656)	(32,658)
Loss on early extinguishment of debt	(1,207)	
Other income, net	2,687	6,424

Income from continuing operations before income taxes and cumulative effects of accounting changes	\$ 51,141	\$ 73,159
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The Company's geographic area information is as follows:

	North America	Other Foreign	Total
Revenues from external customers:			
Three months ended March 31,			
2005 (Restated note 2)	\$ 444,177	\$ 10,694	\$ 454,871
2004 (Restated note 2)	\$ 451,288	\$ 137,411	\$ 588,699
Gains and impairment (losses) on dispositions, net:			
Three months ended March 31,			
2005 (Restated note 2)	\$ (5,741)	\$	\$ (5,741)
2004 (Restated note 2)	\$ 34,693	\$ 92	\$ 34,785
Operating income:			
Three months ended March 31,			
2005 (Restated note 2)	\$ 71,253	\$ 3,064	\$ 74,317
2004 (Restated note 2)	\$ 85,461	\$ 13,932	\$ 99,393
Depreciation and amortization:			
Three months ended March 31,			
2005 (Restated note 2)	\$ 20,915	\$ 174	\$ 21,089
2004 (Restated note 2)	\$ 35,459	\$ 868	\$ 36,327
Total assets at:			
March 31, 2005 (Restated note 2)	\$ 7,660,950	\$ 130,801	\$ 7,791,751
December 31, 2004 (Restated note 2)	\$ 8,048,337	\$ 157,350	\$ 8,205,687

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

	Three months ended March 31,	
	2005	2004
	(Restated)	(Restated)
	note 2	note 2
Revenues from external customers	\$ 416,699	\$ 422,905
Operating income	\$ 64,594	\$ 76,207
Depreciation and amortization	\$ 19,729	\$ 32,927
Total assets (a)	\$ 7,292,972	\$ 7,671,171

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

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

	Three months ended March 31,	
	2005	2004
Revenues from external customers	\$	\$ 127,282

Operating income	20	\$	\$	11,664
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The changes in the carrying amounts of goodwill for the Company's two segments are as follows:

	Funeral	Cemetery	Total
Balance as of December 31, 2004	\$ 1,166,657	\$ 2,383	\$ 1,169,040
Dispositions	(5,836)		(5,836)
Effects of foreign currency and other	(871)	(118)	(989)
Balance as of March 31, 2005	\$ 1,159,950	\$ 2,265	\$ 1,162,215

8. Supplementary Information

The detail of certain income statement accounts is as follows for the quarters ended March 31,

	2005 (Restated) note 2	2004 (Restated) note 2
North America revenues, net		
Goods		
Funeral	\$ 140,401	\$ 132,370
Cemetery	82,722	97,607
Total goods	223,123	229,977
Services		
Funeral	169,132	163,915
Cemetery	36,337	38,004
Total Services	205,469	201,919
North America revenues, net	428,592	431,896
International revenues	10,694	137,411
Other revenues	15,585	19,392
Total revenues, net	\$ 454,871	\$ 588,699
North America costs		
Goods		
Funeral	\$ 76,803	\$ 74,662
Cemetery	34,581	43,316
Total cost of goods	111,384	117,978
Services		
Funeral	69,339	62,356
Cemetery	23,904	25,021

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Total cost of services	93,243	87,377
North America costs	204,627	205,355
International cost of goods and services	7,630	123,571
Overhead and other expenses	142,840	144,144
Total costs	\$ 355,097	\$ 473,070

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The Company is a party to various litigation matters, investigations and proceedings. For each of its outstanding legal matters, the Company evaluates the merits of the case, its exposure to the matter, possible legal or settlement strategies and the likelihood of an unfavorable outcome. If the Company determines that an unfavorable outcome is probable and can be reasonably estimated, it establishes the necessary accruals. Certain insurance policies held by the Company may reduce cash outflows with respect to an adverse outcome of certain of these litigation matters. The Company accrues such insurance recoveries when they become probable of being paid and can be reasonably estimated. The following discussion describes certain litigation and proceedings as of May 13, 2005.

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

David Hajar v. SCI Texas Funeral Services, Inc., SCI Funeral Services, Inc., and Service Corporation International.; In the County Court of El Paso, County, Texas, County Court at Law Number Three; Cause Number 2002-740, with an interlocutory appeal pending in the El Paso Court of Appeals, No. 08-05-00182-CV (Hajar Lawsuit). The Hajar Lawsuit is a state-wide class action brought on behalf of all persons, entities and organizations who purchased funeral services from the Company or its subsidiaries in Texas at any time since March 18, 1998. Plaintiffs allege that federal and Texas funeral related regulations and/or statutes (Rules) required the Company to disclose its markups on all items obtained from third parties in connection with funeral service contracts and that the failure to make certain disclosures of markups resulted in breach of contract and other legal claims. The Hajar Lawsuit seeks to recover an unspecified amount of monetary damages. The plaintiffs also seek attorneys' fees, costs of court, pre- and post-judgment interest, and unspecified injunctive and declaratory relief. The Company denies that plaintiffs have standing to sue for violations of the Texas Occupations Code, denies that any breaches of contractual terms occurred, and otherwise and on other grounds denies liability on all of the plaintiffs' claims. Finally, the Company denies that the Hajar Lawsuit satisfies the requirements for class certification.

Each side in the Hajar Lawsuit filed motions to summarily establish that its interpretation of the Rules was correct, and the judge has ruled in favor of the plaintiffs. This ruling allows the plaintiffs to proceed with the case. The trial court entered an order certifying the class and two subclasses on April 15, 2005. On April 29, 2005, the trial court entered an order imposing sanctions against the Company and (i) finding that the Company breached its contracts by failing to disclose that funeral goods and services were purchased from third parties and resold to customers at higher prices, and by failing to disclose the amount of price mark-ups, and (ii) approving a damage calculation methodology proposed by the plaintiffs under which the damages would equal the difference between the costs to the Company of items of funeral goods and services purchased from third parties and the price at which they were resold to persons arranging funerals, minus any legally proper off-sets. On April 29, 2005, pursuant to section 51.014(a)(3) of the Texas Civil Practice and Remedies Code, the Company filed a notice of appeal regarding the trial court's order certifying a class, and it appears from section 51.014(b) that this interlocutory appeal also stays all other proceedings in the trial court pending resolution of that appeal. In response to requests from the District Clerk and the court reporters responsible for preparing the appellate record, the El Paso Court of

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Appeals has extended the deadline for filing the Clerk's Record to May 29, 2005 and the deadline for filing the Reporter's Records to June 23, 2005. The briefing schedule does not begin until the last of these records is filed.

The ultimate outcome of the Hajar Lawsuit cannot be determined at this time. An adverse decision in the Hajar Lawsuit could have a material adverse effect on the Company, its financial condition, results of operation and cash flows. However, the Company intends to aggressively defend this lawsuit and pursue the pending interlocutory appeal.

Mary Louise Baudino, et al v. Service Corporation International, et al; the plaintiffs' counsel in the Hajar Lawsuit initiated an arbitration claim raising similar issues in California and filed in November 2004 a case styled *Mary Louise Baudino, et al v. Service Corporation International, et al*; in Los Angeles County Superior Court; Case No. BC324007 (Baudino Lawsuit). The Baudino Lawsuit makes claims similar to those made in the Hajar lawsuit. However, the Baudino Lawsuit seeks a nation-wide class of plaintiffs. The Baudino Lawsuit is in its early stages and no discovery has been conducted. The ultimate outcome of the Baudino Lawsuit cannot be determined at this time. However, the Company intends to aggressively defend this action.

Funeral Consumers Alliance, Inc. et al v. Service Corporation International et al; In the United States District Court for the Northern District of California; Case No. C0501804 (2005 Consumer Lawsuit). The 2005 Consumer Lawsuit, filed in May 2005, is a purported class action on behalf of all persons and entities who have purchased caskets in the United States. The suit names as defendants the Company and four other public companies involved in the funeral or casket industry. The plaintiffs allege that defendants violated federal and state antitrust laws by engaging in anticompetitive practices with respect to sales of caskets and overcharged for caskets. The 2005 Consumer Lawsuit seeks injunctions, an unspecified amount of monetary damages and treble damages. Since the 2005 Consumer Lawsuit is in its preliminary stages, no discovery has occurred and the Company cannot quantify its ultimate liability, if any, for the payment of damages. The Company intends to aggressively defend itself in this action.

10. Earnings Per Share

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

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

	Three months ended	
	March 31,	
	2005	2004
	(Restated)	(Restated)
	note 2	note 2
Income from continuing operations before cumulative effects of accounting changes (numerator):		
Income from continuing operations before cumulative effects of accounting changes basic	\$ 33,242	\$ 76,938
After tax interest on convertible debt	12	3,562
Income from continuing operations before cumulative effects of accounting changes diluted	\$ 33,254	\$ 80,500
Net (loss) income (numerator):		
Net (loss) income basic	\$ (154,946)	\$ 30,136
Interest on convertible debt	12	3,562
Net (loss) income diluted	\$ (154,934)	\$ 33,698
Shares (denominator):		
Shares basic	313,490	303,018
Stock options	4,086	4,211
Restricted stock	54	6
Convertible debt	121	45,853
Shares diluted	317,751	353,088
Income from continuing operations per share before cumulative effects of accounting changes:		
Basic	\$.11	\$.25
Diluted	\$.10	\$.23
Cumulative effects of accounting changes per share, net of tax:		
Basic	\$ (.60)	\$ (.15)
Diluted	\$ (.59)	\$ (.13)
Net (loss) income per share:		
Basic	\$ (.49)	\$.10
Diluted	\$ (.49)	\$.10

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

Three months ended

	March 31,	
	2005	2004
Antidilutive options	8,912	10,709
Antidilutive convertible debt	859	581
Total common stock equivalents excluded from computation	9,771	11,290

Table of Contents**11. Stockholders Equity***Stock Options*

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

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

	Three months ended March 31,	
	2005	2004
	(Restated) note 2	(Restated) note 2
Net (loss) income	\$ (154,946)	\$ 30,136
Deduct: Total additional stock-based employee compensation expense determined under fair value based method for all awards, net of related tax expense	(391)	(779)
Pro forma net (loss) income	\$ (155,337)	\$ 29,357
Basic (loss) earnings per share:		
Net (loss) income	\$ (.49)	\$.10
Deduct: Total additional stock-based employee compensation expense determined under fair value based method for all awards, net of related tax expense		
Pro forma basic (loss) earnings per share	\$ (.49)	\$.10
Diluted (loss) earnings per share:		
Net (loss) income	\$ (.49)	\$.10
Deduct: Total additional stock-based employee compensation expense determined under fair value based method for all awards, net of related tax expense		
Pro forma diluted (loss) earnings per share	\$ (.49)	\$.10

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

Table of Contents*Accumulated Other Comprehensive (Loss) Income*

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

	Foreign currency translation adjustment	Minimum pension liability adjustment	Unrealized gains and losses	Accumulated other comprehensive (loss) income
Balance at December 31, 2004	\$ (38,349)	\$	\$	\$ (38,349)
Activity in 2005	(6,469)			(6,469)
Reduction in net unrealized gains associated with available-for-sale securities of the trusts			(43,577)	(43,577)
Reclassification of net unrealized gains activity attributable to the non-controlling interest holders			43,577	43,577
Reclassification for translation adjustment realized in net loss	71,770			71,770
Balance at March 31, 2005	\$ 26,952	\$	\$	\$ 26,952
Balance at December 31, 2003	\$ (78,113)	\$ (33,599)	\$	\$ (111,712)
Activity in 2004	13,953	33,599		47,552
Balance at March 31, 2004	\$ (64,160)	\$	\$	\$ (64,160)

The reclassification adjustment of \$71,770 during the three months ended March 31, 2005 relates to the sale of the Company's Argentina and Uruguay operations.

The components of Comprehensive (loss) income are as follows:

	Three months ended March 31,	
	2005	2004
	(Restated) note 2	(Restated) note 2
Comprehensive (loss) income:		
Net (loss) income	\$ (154,946)	\$ 30,136
Total other comprehensive income	65,301	47,552
Comprehensive (loss) income	\$ (89,645)	\$ 77,688

Share Repurchase Program

On February 10, 2005, the Company announced an increase in the share repurchase program authorizing the investment of up to an additional \$100,000 to repurchase its common stock for an aggregate authorized amount of \$300,000. The Company, subject to market conditions and normal trading restrictions, makes purchases in the open market or through privately negotiated transactions. During the first quarter of 2005, the Company repurchased 14,651 shares of common stock at an aggregate cost of \$103,570.

Cash Dividend

In the first quarter of 2005, the Company's Board of directors approved a cash dividend of \$.025 per common share payable in the second quarter of 2005. At March 31, 2005, this dividend totaling \$7,734 was recorded in *Accrued Liabilities* and *Capital in Excess of Par Value* in the condensed consolidated balance sheet.

Table of Contents**12. Gains and Impairment (Losses) on Dispositions, Net***Gains and Impairment (Losses) on Dispositions for the Three Months Ended March 31, 2005 and 2004*

As dispositions occur in the normal course of business, gains or losses on the sale of such businesses are recognized in the income statement line item *Gains and impairment (losses) on dispositions, net*. Additionally, as dispositions occur related to the Company's ongoing asset sale programs, adjustments are made through this income statement line item to reflect the difference between actual proceeds received from the sale compared to the original estimates.

Gains and impairment (losses) on dispositions, net consists of the following:

	Three months ended	
	March 31,	
	2005	2004
	(Restated)	(Restated)
	note 2	note 2
Gains on dispositions	\$ 889	\$ 41,532
Impairment losses for assets held for sale	(7,118)	(5,940)
Changes to previously estimated impairment losses	488	(807)
	\$ (5,741)	\$ 34,785

Sale of French Operations

During 2004, the Company sold 100% of the stock of its French subsidiary to a newly formed company (NEWCO). In connection with this sale, the Company acquired a 25% share of the voting interest of NEWCO, received cash proceeds of \$281,667, net of transaction costs, and received a note receivable in the amount of EUR 10,000. Also received in this transaction were EUR 15,000 of preferred equity certificates and EUR 5,955 of convertible preferred equity certificates. The Company accounted for the sale of its French subsidiary in accordance with the guidance set forth in EITF 01-2, *Interpretations of APB Opinion No. 29*, Issues 8(a) and 8(b). Consequently, the Company deferred approximately 25% of the gain associated with the sale of its French subsidiary representing the economic interest it retained in that subsidiary through its ownership of approximately 25% of NEWCO.

The sale of stock of the Company's French subsidiary in March 2004, resulted in a pretax gain of \$12,639 and a non-cash tax benefit of \$24,929 (described below) resulting in an after tax gain of \$37,568. In July 2004, the Company paid \$6,219 pursuant to the joint venture agreement, as a purchase price adjustment, which reduced the pretax gain to \$6,420 and reduced the after tax gain to \$33,624 as summarized below.

	Original		
	Calculation	Adjustment	Total
	Q1 2004	in Q2 2004	
Pretax gain (loss)	\$ 12,639	\$ (6,219)	\$ 6,420
Tax benefit	(24,929)	(2,275)	(27,204)
After tax gain (loss)	\$ 37,568	\$ (3,944)	\$ 33,624

The \$24,929 non-cash tax benefit associated with the sale of the Company's French subsidiary is primarily attributable to the reduction of tax accruals by \$18,610, which were accrued as an indemnification liability upon the sale of the Company's French subsidiary. The remaining amount of \$6,319 was a non-cash tax benefit associated with the difference between book and tax basis.

Included in the pretax gain, the Company recognized \$35,768 of contractual obligations related to representations and warranties and other indemnifications resulting from the joint venture contract. During 2004, \$2,400 in charges was applied to the

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indemnifications and related primarily to foreign taxes and legal expenses. The Company applied \$772 to the indemnifications during the first quarter of 2005. Also, goodwill in the amount of \$23,467 was removed from the Company's consolidated balance sheet as a result of this transaction.

NEWCO completed a refinancing in May 2005 and is expected to complete an additional refinancing during the third quarter of 2005 in order to reduce its cost of debt. Expected to be included in this refinancing is the note payable to the Company in the amount of EUR 10,000 plus interest and the redemption of the Company's investment in preferred equity certificates and convertible preferred equity certificates totaling EUR 20,955 plus interest. The Company has recorded interest income of \$2,379 related to interest on these preferred equity certificates and convertible preferred equity certificates as of March 31, 2005. The Company's investment in common stock and 25% voting interest is expected to remain unchanged as a result of this transaction.

Proceeds from Investment in United Kingdom Company

The Company recognized income of \$27,179, recorded in *Gains and impairment (losses) on disposition, net*, in the consolidated statement of operations as of March 31, 2004, to adjust the carrying amount of its note receivable from its former United Kingdom company to its realizable value. In addition, the Company recognized interest income on the note receivable, in the amount of \$4,478 recorded in *Other income, net* in the consolidated statement of operations as of March 31, 2004. In the second quarter of 2004, the Company recorded a pretax gain of \$13,984 in *Gains and impairment (losses) on dispositions, net* in the consolidated statement of operations, as a result of the sale and recognized a non-cash tax benefit of \$8,000.

During the second quarter of 2004, the Company received proceeds of \$53,839 from the sale of its minority interest equity investment in the United Kingdom and the prepayment of its note receivable, with accrued interest, following a successful public offering transaction of its United Kingdom company.

Sale of Argentina and Uruguay Operations

During the second quarter of 2004, the Company recorded an impairment of its funeral and cemetery operations in Argentina in the amount of \$15,189 recorded in *Loss from discontinued operations* in the consolidated statement of operations. As a result of the sale of the Argentina and Uruguay businesses in 2005, the Company recorded a gain of \$2,041 in *Income from discontinued operations* in the consolidated statement of operations in December 2004 associated with the revised estimated fair value. The new carrying amount reflected the fair value based on current market conditions less costs to sell. Additionally, the Company recognized a non-cash tax benefit of \$49,236 in discontinued operations during the second quarter of 2004, which represents the reduction of a previously recorded valuation allowance. The Company also recognized an additional tax benefit of \$2,629 in discontinued operations during the fourth quarter of 2004, which represents the revised estimated fair value and differences between book and tax basis.

13. Discontinued Operations

The Company committed to a plan during the second quarter of 2004 to divest its existing funeral and cemetery operations in Argentina and Uruguay. Accordingly, these operations are classified as discontinued operations for all periods presented. The provision for income taxes in the amount of \$594 in the first quarter of 2005 results from a state net operating loss valuation allowance and a tax accrual release. During the first quarter of 2005, the Company disposed of its operations in Argentina and Uruguay.

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The results of the Company's discontinued operations for the three months ended March 31, 2005 and 2004 were as follows:

	Three months ended March 31,	
	2005	2004
Revenues	\$ 1,749	\$ 3,500
Other costs and expenses	(1,805)	(2,605)
(Loss) income from discontinued operations before income taxes	(56)	895
Provision for income taxes	594	141
(Loss) income from discontinued operations	\$ (650)	\$ 754

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**Introduction**

At March 31, 2005, Service Corporation International (SCI or the Company) operated 1,190 funeral service locations (1,169 in North America) and 393 cemeteries (390 in North America). We also had a 25% minority interest equity investment in funeral operations in France. We also own Kenyon International Emergency Services, a disaster response team that engages in mass fatality and emergency response services.

Our funeral and cemetery operations are organized into a North America division covering the United States and Canada, and an Other Foreign division including operations in Chile, Germany and Singapore. In 2004, our Other Foreign division also included operations in France, which were disposed of in the first quarter of 2004. For the quarter ended March 31, 2005, our North America operations represented approximately 97.6% of our consolidated revenues and approximately 96.9% of our consolidated gross profits.

Our operations in the North America division 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 four market support centers in North America to assist market directors with financial, administrative and human resource needs. These support centers are located in Houston, Miami, New York and Los Angeles. The primary functions of the market support centers are to 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. Despite some consolidation, the industry remains fragmented. We estimate that SCI and the other public companies 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.

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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 Memorial® 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.

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 consistent 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 which are included in our consolidated balance sheet or third party insurance policies, which are not included in our consolidated balance sheet.

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 2 of this amended Form 10-Q.

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 preferences, environmental issues and cultural preferences are driving an increasing preference for cremation. SCI is the largest provider of cremation services in North America where approximately 40% of the total funeral services we perform are cremation services. 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.

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The Path to Growth

We have taken significant actions in recent years to improve our infrastructure and reduce overhead costs as further described below. In doing so, we believe we have now established a solid platform for future growth. We believe strategies centered on our national brand, Dignity Memorial[®], and other revenue growth initiatives, along with a continued focus on cost management, will 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 reduce 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 November 2003, we eliminated the dual management structures of sales and operations and replaced them with a single-line business management structure while also improving our corporate support system by establishing market support centers.

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. Internally, we are focused on ensuring that we have consistency in service standards and processes across our network of businesses.

Externally, we continue to enhance signage and local advertising efforts using the Dignity Memorial[®] name and logo. Through our national brand we are the sponsor of several nationally recognized community programs. We also have a national advertising and marketing campaign to promote awareness of our brand name throughout North America that focuses on the distinct benefits and values that set Dignity Memorial[®] apart from other providers

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 Memorial[®] brand and focusing on our customers' concerns and satisfaction.

Through our Dignity Memorial[®] 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 Memorial[®] providers include special rates on airfare, care rentals and hotel accommodations; grief counseling services; a legal services membership; internet memorial archive capabilities through Making Everlasting Memories[®], or MeM[®] (www.mem.com); and the Aftercare[®] Planner—a comprehensive organization system that helps families manage the many financial details that arise after a death occurs. 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 deceased 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 Memorial[®] packaged plans. Our national brand name represents a unique set of packaged funeral and cremation plans offered exclusively through our network on an at-need and pre-need basis. These packages are designed to simplify customer decision-making

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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 Dignity Memorial® provider in North America. We continue to receive positive feedback from consumers regarding the value of these packages. In addition, when Dignity Memorial® packages are sold, it results in significant incremental revenue and gross profit margin per funeral service compared to non-packaged sales due to the comprehensive product and service offerings these packages 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. 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.

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 operation 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 March 31, 2005, 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. This includes deferred revenues associated with insurance funded contracts which are not included in the Company's consolidated balance sheet. 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. 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

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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 which 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. We believe that a national brand name will provide us access to new customers over the long term. 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. We are also developing marketing strategies that will target growing segments of the population.

Expanding through acquisition, construction, or franchise. We are 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. We intend to focus construction efforts on developing 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 investment to us.

Focusing on employee development and customer satisfaction. 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 19,000 individuals that we employ in North America.

We have recently partnered with J.D. Power and Associates, one of the world's premier marketing firms specializing in customer satisfaction, to assist us with better understanding and measuring feedback from our consumers. We launched new customer surveys in March 2005. Our new survey to client families utilizes a combined approach measuring satisfaction and loyalty and the relationship between the two.

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.

Critical Accounting Policies and Accounting Changes

Deferred Selling Costs

Effective January 1, 2005, we changed our method of accounting for direct selling costs incurred related to the acquisition of preneed funeral and preneed cemetery contracts. Prior to this change, we capitalized such direct selling costs and amortized the costs in proportion to the revenue recognized. Under the new method of accounting, we expense these direct selling costs as incurred. We believe the new method is preferable because it better reflects the economics of the business.

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The direct selling costs were capitalized based on deferral rates that we established and varied by preneed funeral contracts and preneed cemetery items, based on the ratio of the direct selling compensation and related fringe costs to preneed funeral and cemetery production. We did not attribute deferred selling costs to each individual contract (or each item in the case of cemetery deferred selling costs). Management believed that using the proportionate method of amortization allowed for a systematic match of costs with related revenues given the relatively homogenous nature of the preneed funeral and preneed cemetery contract items. However, management believes that expensing direct selling costs as incurred is preferable as expensing such costs is consistent with Statement of Position 93-7 *Reporting on Advertising Costs* for similar types of items, given that we do not maintain direct selling costs by individual contract or item.

Prior to the accounting change, we allocated significant employee resources to accounting for deferred selling costs and did not maintain deferred selling costs at a contract level or item level detail in order to exactly amortize the item level costs when the associated revenue was appropriately recognized. We believe that expensing these selling costs as incurred is the preferable method of accounting for the reasons noted above and because it eliminates the burden of maintaining deferred selling cost records.

Finally, we manage our business based on cash flow. Management believed that expensing these deferred selling costs was preferable as it better aligns the costs of obtaining the preneed funeral and preneed cemetery contract with the cash outflows associated with obtaining such contracts.

As of January 1, 2005, we recorded a cumulative effect of \$187.5 million, net of tax of \$117.4 million. This amount represents the cumulative balance of deferred selling costs recorded on our consolidated balance sheet in *Deferred charges and other assets* at the time of the accounting change. If we had not changed our method of accounting for direct selling costs as described above, net income for the first quarter of 2005 would have been \$2.3 million after tax or \$.01 per basic and diluted share higher than currently reported.

The three months ended March 31, 2004 pro forma amounts in the table below reflect the new policy to expense selling costs as incurred. The effect of the change for the quarter ended March 31, 2004 would have decreased net income from continuing operations before cumulative effects of accounting changes by approximately \$2.8 million after tax or \$.01 per basic and diluted share.

	Three months ended March 31, 2004		
		Deferred selling	
	Historical (Restated) note 2	costs, net (1)	Pro forma (Restated) note 2
(Dollars in thousands, except per share amounts)			
Gross profits:			
Funeral	\$ 86,559	\$ (487)	\$ 86,072
Cemetery	29,070	(3,894)	25,176
	115,629	(4,381)	111,248
Income (loss) from continuing operations before income taxes and cumulative effects of accounting changes	\$ 73,159	\$ (4,381)	\$ 68,778
Net income (loss)	\$ 30,136	\$ (2,848)	\$ 27,288
Amounts per common share:			
Net income (loss) basic	\$.10	\$ (.01)	\$.09
Net income (loss) diluted	\$.10	\$ (.01)	\$.09

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

Other Than Temporary Impairments

In 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

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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, financial position, or cash flows.

Income Taxes

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 Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. Among other items, SFAS 123R eliminates the use of the intrinsic value method of accounting, and requires companies to recognize the cost of employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements. The effective date of SFAS 123R is the first annual reporting period beginning after June 15, 2005, which is the first quarter of 2006 for SCI.

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 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 January 1, 2006. We are currently evaluating the impact that this adoption will have on our results of operations.

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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 consolidation of merchandise and service trusts and cemetery perpetual care trusts for which we are the primary beneficiary (i.e., those for which the Company absorbs a majority of the trusts' expected losses). The Company is the primary beneficiary of a trust whenever a majority of the assets of the trust are attributable to deposits of 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 the Company's consolidated statement of cash flows; however, it does require certain financing and investing activities to be disclosed.

Although FIN 46R requires consolidation of most of the merchandise and service and perpetual care trusts, it does not change the legal relationships among the trusts, 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 classifies deposits to cemetery perpetual care trusts as non-controlling equity interests.

We record cash received from customers, that is payable to the trusts but not yet required to be deposited in the trusts, as restricted cash in *Deferred charges and other assets* in our consolidated balance sheet. At March 31, 2005, these pending deposits totaled \$13.4 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* offset 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

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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 income (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 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 eleven of the consolidated financial statements. However, our *Accumulated other comprehensive income (loss)* balance on the face of the balance sheet is ultimately not affected by consolidation of the trusts.

Consolidation of Certain Cemeteries: Prior to December 31, 2003, we operated certain cemeteries in Michigan which 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 SCI in exchange for a long-term sales, accounting, and cash management agreement. In accordance with this agreement, we receive 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, we determined ourselves 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, we 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.

Table of Contents*Pension Plans*

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. 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 liabilities 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.

Results of Operations Three Months Ended March 31, 2005 and 2004

At December 31, 2004, we restated results for the first three interim periods of 2004. Subsequently, we have restated our condensed consolidated statements of operations for the three months ended March 31, 2005 and 2004 and our consolidated balance sheets as of March 31, 2005 and December 31, 2004. For details relating to this restatement, see note two to the consolidated financial statements and the Company's Form 10-K/A (Amendment No. 2) for the year ended December 31, 2004. Effective January 1, 2005, we changed our accounting for preneed selling costs. For details surrounding this accounting change, see note four to the consolidated financial statements.

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

Net loss for the three months ended March 31, 2005, was \$154.9 million or \$.49 per diluted share compared to net income of \$30.1 million or \$.10 per diluted share in the same period of 2004. These results included cumulative effects of accounting changes, litigation expenses, gains and losses on dispositions, 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 \$8.1 million or \$.02 of earnings per diluted share in the first three months of 2004.

Net (loss) income in the periods presented was affected by the following items, which are presented on an after tax basis:

Three Months Ended March 31, 2005:

A charge of \$187.5 million or \$.59 per diluted share for the cumulative effect of the change in accounting related to preneed selling expenses.

Net loss on dispositions of \$3.7 million or \$.02 per diluted share.

Net loss on early extinguishment of debt of \$0.8 million or less than \$.01 per diluted share related to certain purchases of 7.7% notes due April 2009.

A net loss of \$0.7 million or less than \$.01 per diluted share from discontinued operations.

Three Months Ended March 31, 2004:

A charge of \$47.6 million or \$.13 per diluted share for the cumulative effects of accounting changes related to the implementation of FIN 46R and changes in pension accounting.

Expenses of \$22.5 million or \$.06 per diluted share related to outstanding litigation matters.

Net gain on dispositions of \$51.4 million or \$.14 per diluted share (including tax benefits realized from the disposition of our French operations and a minority interest in our former United Kingdom company).

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

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Net earnings of \$0.8 million or less than \$.01 per diluted share from discontinued operations.

The consolidated effective tax rate in the first quarter of 2005 was a provision of 35.0% compared to a benefit of 5.2% in 2004. The tax rate in 2004 was favorably impacted by tax benefits realized from the disposition of our funeral operations in France and the United Kingdom. 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.

The diluted weighted average number of shares decreased to 317.8 million at March 31, 2005 compared to 353.1 million at March 31, 2004. This decrease is mainly due to our share repurchase program which began in the third quarter of 2004. 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 issuance of common stock or treasury stock. The Company's matching cash contribution was previously required to be invested in SCI stock. Effective April 1, 2005, we changed our policy to allow employees the choice to allocate the Company's matching contributions to a variety of investment options.

Consolidated Funeral Results

Funeral revenues in the three months ended March 31, 2005 declined \$115.1 million from 2004 primarily due to a decline of \$127.3 million in revenues associated with our French funeral operations, which were sold on March 11, 2004. North America funeral revenue increased \$11.9 million primarily as a result of an increase in average revenue per funeral service and a \$7.1 million increase in revenues from Kenyon, our subsidiary that engages in mass fatality and emergency response services. Kenyon revenues were higher in the first quarter of 2005 than in the first quarter of 2004 primarily due to its involvement with the tsunami disaster that occurred in Asia at the end of 2004.

Funeral gross profits decreased \$6.9 million in the three months ended March 31, 2005 compared to the same period in 2004 primarily as a result of an \$11.6 million decline in gross profits related to our former French operations, which were sold in March 2004. North America funeral gross profits increased \$4.7 million despite our change in accounting related to deferred selling costs, which had an effect of \$0.5 million. This increase in gross profit is primarily related to an increase in average revenue per funeral service, an increase in Kenyon revenue, and an improvement in overhead expenses, partially offset by a decline in GA revenue, and an increase of approximately \$7.0 million of expenses related to Kenyon.

Consolidated Cemetery Results

Cemetery revenues decreased \$18.8 million in the three months ended March 31, 2005 compared to the same period of 2004. North America cemetery revenues decreased \$19.0 million primarily as a result of less constructed cemetery property revenue and decreases in cemetery preneed production. Cemetery gross profits decreased \$8.9 million in the three months ended March 31, 2005 compared to the same period of 2004 primarily as a result of the decreases in revenues described above, as well as the effect of our change in accounting related to deferred selling costs, which had an effect of \$3.9 million.

General and Administrative Expenses

General and administrative expenses were \$19.7 million in the three months ended March 31, 2005 compared to \$51.0 million in the same period of 2004. We recognized litigation expenses of \$35.0 million in the first quarter of 2004. Excluding litigation expenses, general and administrative expenses in the three months ended March 31, 2005 were \$19.7 million compared to \$16.0 million in the same period of 2004. This increase is the result of increased professional fees of \$3.5 million associated with Sarbanes-Oxley compliance and the costs of our funeral and cemetery verification projects. General and administrative expenses excluding litigation expenses 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.

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Other

In the first quarter of 2005, we recognized a net pretax loss on dispositions of \$5.7 million associated with certain dispositions in North America. In the first quarter of 2004, we recognized a net pretax gain on dispositions of \$34.8 million predominantly related to gains of \$12.6 million from the sale of our funeral operations in France and the adjustment of \$27.2 million to a note receivable associated with a United Kingdom company to its realizable value. The gains in the first quarter of 2004 were partially offset by net losses associated with the disposition of certain funeral and cemetery businesses in North America.

Interest expense decreased to \$24.7 million in the three months ended March 31, 2005 compared to \$32.7 million in the same period of 2004. These declines are consistent with the Company's decreases in debt.

Other income, net was \$2.7 million in the three months ended March 31, 2005 compared to \$6.4 million in the same period of 2004. The components of other income for the periods presented were as follows:

Interest income was \$4.1 million and \$6.3 million in the first quarters of 2005 and 2004, respectively. Included in the first quarter of 2005 was \$2.4 million of interest income from our French operations for preferred equity certificates and convertible preferred equity certificates. The first quarter of 2004 included the receipt of \$4.5 million of interest income related to a note receivable collected from a United Kingdom company.

Cash overrides received from a third party insurance provider related to the sale of insurance funded preneed funeral contracts were \$1.6 million in the first quarter of 2005 and the first quarter of 2004.

Surety bond premium costs were \$1.0 million in the first quarter of 2005 compared to \$1.1 million in the first quarter of 2004.

The remaining expense of \$2.0 million in the first quarter of 2005 and \$0.4 million in the first quarter of 2004 is primarily related to net losses from foreign currency transactions.

Comparable Results of Operations Three Months Ended March 31, 2005 and 2004

The table below reconciles our actual results to our comparable or same store results for the periods ended March 31, 2005 and 2004. 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, 2004 or divested prior to March 31, 2005. Therefore, in the following two periods presented, 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.

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(Dollars in thousands) 2005	Actual (Restated)	Activity associated with acquisition/new construction	Activity associated with dispositions	Comparable (Restated)
North America				
Funeral revenue	\$ 316,268	\$ 472	\$ 898	\$ 314,898
Cemetery revenue	127,909		(1,084)	128,993
	444,177	472	(186)	443,891
Other foreign				
Funeral revenue	3,183			3,183
Cemetery revenue	7,511		82	7,429
	10,694		82	10,612
Total revenues	\$ 454,871	\$ 472	\$ (104)	\$ 454,503
North America				
Funeral gross profits	\$ 79,065	\$ 104	\$ (1,217)	\$ 80,178
Cemetery gross profits	17,645		(2,579)	20,224
	96,710	104	(3,796)	100,402
Other foreign				
Funeral gross profits	557			557
Cemetery gross profits	2,507		(40)	2,547
	3,064		(40)	3,104
Total gross profits	\$ 99,774	\$ 104	\$ (3,836)	\$ 103,506

(Dollars in thousands) 2004	Actual (Restated)	Activity associated with acquisition/new construction	Activity associated with dispositions	Comparable (Restated)
North America				
Funeral revenue	\$ 304,361	\$	\$ 7,129	\$ 297,232
Cemetery revenue	146,927		1,656	145,271
	451,288		8,785	442,503
Other foreign				
Funeral revenue	130,160		127,282	2,878
Cemetery revenue	7,251		223	7,028

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	137,411		127,505	9,906
Total revenues	\$ 588,699	\$	\$ 136,290	\$ 452,409
North America				
Funeral gross profits	\$ 74,356	\$	\$ (496)	\$ 74,852
Cemetery gross profits	27,433		(9)	27,442
	101,789		(505)	102,294
Other foreign				
Funeral gross profits	12,203		11,572	631
Cemetery gross profits	1,637		(28)	1,665
	13,840		11,544	2,296
Total gross profits	\$ 115,629	\$	\$ 11,039	\$ 104,590

Other Foreign revenues and gross profits shown in the preceding tables 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 quarter ended March 31, 2005, they are not considered comparable or same store locations.

The following table provides the components to calculate our comparable average revenue per funeral service in North America for the three months ended March 31, 2005 and 2004. 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

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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 millions, except average revenue per funeral service)

	2005	2004
	(Restated)	(Restated)
Comparable North America funeral revenue	\$ 314.9	\$ 297.2
Less: GA revenues (1)	6.7	8.0
Kenyon revenues (2)	8.1	1.0
Adjusted Comparable North America funeral revenue	300.1	288.2
Comparable North America funeral services performed	69,842	69,368
North America average revenue per funeral service	\$ 4,297	\$ 4,155

(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.

Comparable North America Funeral

Comparable North America funeral revenues in the first quarter of 2005 increased \$17.7 million or 5.9% from 2004 primarily due to a \$7.1 million increase in revenues from Kenyon, increases in funeral volume, an increase in the average revenue per funeral service, partially offset by a decrease in GA revenue.

The number of funeral services performed increased 0.7% in 2005 compared to the same period in 2004 primarily attributable to increased volumes in February and March related to a late 2005 influenza season. The comparable average revenue per funeral service increased 3.4% in the first quarter of 2005 compared to the prior year period. The first quarter of 2005 represents the nineteenth 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. 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 the first quarter of 2005, 40.2% were cremation services versus 39.6% in the same period of 2004.

Funeral gross profit improved \$5.3 million or 7.1%. This improvement is primarily a result of the increase in revenue described above and continued reduction in overhead expenses, partially offset by our change in accounting for deferred selling costs, a decline in GA revenue, and an increase of approximately \$7.0 million of expenses related to Kenyon. In 2004, we deferred and amortized preneed funeral direct selling costs. Effective January 1, 2005, we are now expensing these costs as incurred. Had we expensed funeral preneed selling costs as incurred in 2004, funeral gross profits in the first quarter of 2004 would have been reduced by approximately \$0.5 million.

Comparable North America Cemetery

North America cemetery revenue decreased \$16.3 million or 11.2% from the first quarter of 2005 to \$129.0 million. This decline is primarily a result of decreases in cemetery preneed production and expected declines in legacy revenues associated with the recognition of constructed property revenues that were sold prior to 2005. This expected reduction is due to our shift in strategy to focus on shortening the time between when property is sold and when it is constructed. This decline in recognized preneed revenue was partially offset by an increase in atneed sales of property, merchandise and services.

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Cemetery gross profits decreased 26.3% or \$7.2 million in the three months ended March 31, 2005 compared to the same period in 2004. Reductions in overhead costs, selling costs, and maintenance expenses helped to offset the declines in revenue described above as well as increases in costs related to our change in accounting for preneed cemetery direct selling costs. In 2004, we deferred and amortized preneed cemetery direct selling costs. Effective January 1, 2005, we are now expensing these costs as incurred. Had we expensed cemetery preneed selling costs as incurred in 2004, cemetery gross profits in the first quarter of 2004 would have been reduced by \$3.9 million.

Overhead expenses from our field management, market support centers and corporate office, which are allocated to funeral and cemetery operations in North America, were reduced by \$3.9 million or 12.7% in the first quarter of 2005 compared to the first quarter of 2004 primarily as a result of continued improvement in management structure and reduction of fixed costs.

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 are financially sound and have liquidity to consider opportunities to deploy capital and strategic acquisitions at reasonable market values. During the first quarter of 2005, we continued to invest in our share repurchase program and announced the approval of our Board to reinstate a quarterly dividend. Our current credit ratings of *BB* with Standard and Poor's (S&P) and *Ba3* with Moody's Investors Service (Moody's) provide us with adequate access to obtain funds at a reasonable cost, if necessary. Our financial position continues to improve as demonstrated by the following trend in our cash and debt balances:

(In millions)	March 31, 2005	2004	December 31, 2003	2002
Total debt	\$ 1,248.1	\$ 1,254.0	\$ 1,701.9	\$ 1,974.4
Cash and cash equivalents	320.5	287.8	239.4	200.6
Total debt less cash and cash equivalents	\$ 927.6	\$ 966.2	\$ 1,462.5	\$ 1,773.8

Total debt less cash and cash equivalents at March 31, 2005 was \$927.6 million, representing the lowest levels in our company since 1992. Total debt has been reduced by over \$726.3 million or 36.8% since December 31, 2002. This reduction is a result of strong operating cash flows including the receipt of tax refunds of approximately \$130 million, approximately \$240 million in proceeds from the issuance of 6.75% notes due April 1, 2016, and a successful asset divestiture and joint venture program that produced over \$560 million of net cash proceeds.

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 first three months of 2005 compared to the same period of 2004 are as follows:

Operating Activities Cash flows from operations increased by \$39.0 million compared to the first quarter of 2004. The first quarter of 2005 included a \$29.0 million unusual tax refund. Included in the first quarter of 2004 was a \$20.0 million voluntary cash contribution to our pension plan and \$18.3 million in operating cash flows provided by our French operations for the period January 1, 2004 through March 11, 2004. Excluding these items in both periods, cash flows from operations increased \$8.3 million or 9.2%. Cash flows from operating activities that exclude the items above are 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 non-recurring items. Positively affecting cash flow from operations in the first quarter of 2005 compared to the first quarter of 2004 was an approximate \$32 million decrease in payroll and bonus payments and an approximate \$8 million more in net trust fund withdrawals. Negatively affecting cash flows from operations in the first quarter of 2005 compared to the first quarter of 2004 was \$3.9 million of cash outflows for funding the matching contribution of our 401(k) plan with cash, an approximate \$6 million increase in cash outflows

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for professional fees associated with Sarbanes-Oxley compliance and our preneed cemetery backlog verification project, an approximate \$7 million increase in operating expenses associated with Kenyon, and an approximate \$15 million of other working capital declines primarily associated with increased activity late in the quarter and decreases in accounts receivable collections.

Investing Activities Cash flows from investing activities decreased by \$157.9 million primarily due to a decrease in proceeds of \$266.3 million from sales of international businesses and equity investments. In the first quarter of 2005, we received \$21.6 million from the disposition of our Argentina and Uruguay businesses. In the first quarter of 2004, we received \$287.9 million from the sale of our French operations. These cash receipts were partially offset by a \$112.6 million change in restricted cash primarily related to certain litigation matters in Florida in the first quarter of 2004.

Capital expenditures increased \$2.9 million compared to the first quarter of 2004. Capital expenditures in North America increased \$6.0 million due to additional spending on existing facilities, including the renovation of our corporate headquarters as well as new growth initiatives primarily related to cemetery inventory. This was offset by \$2.8 million in capital expenditures included in 2004 associated with our French operations that were sold in March of 2004.

Financing Activities Cash used for financing activities increased \$107.5 million primarily due to the repurchase of Company stock in the first quarter of 2005. During the first quarter of 2005, we repurchased 14.7 million shares of common stock for an aggregate of \$103.5 million. Between April 1, 2005 and May 16, 2005, we purchased an additional 5.5 million shares for \$39.6 million. As of May 16, 2005, the remaining dollar value of shares that may be purchased under our share repurchase programs was approximately \$46.6 million. The remaining increase is due to \$7.7 million in early extinguishment of debt in 2005, partially offset by a \$3.9 million decrease in scheduled debt payments in the first quarter of 2005 compared to the first quarter of 2004.

Liquidity

We believe we have sufficient cash and cash equivalents and a strong trend of operating cash flows. This liquidity affords us the opportunity to consider opportunities to deploy capital strategic acquisitions at reasonable prices and other considerations.

As of March 31, 2005, our cash balance was \$320.5 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 \$62.0 million of letters of credit as of March 31, 2005. We believe these resources are adequate 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.

We expect to generate cash flows in the next several years above our operating and financing needs. We currently have approximately \$238.9 million in debt maturing during the remainder of 2005 and 2006. We believe that this financial flexibility coupled with our liquidity allows us to consider investments or capital structure related transactions that will enhance shareholder value. We will continue to evaluate internal opportunities such as construction of new funeral homes and development of high-end cemetery inventory. We expect to make acquisitions, if such acquisitions are available at reasonable market prices.

In February 2005, the Board of Directors authorized an additional \$100 million for our share repurchase program for an aggregate of \$300 million. From August 2004 through May 16, 2005, we repurchased approximately 36.9 million shares at a total cost of approximately \$253.4 million leaving approximately \$46.6 million for additional repurchases. We plan to continue to make purchases from time to time in the open market or through privately negotiated transactions, subject to market conditions and normal trading restrictions.

In the first quarter of 2005, we announced the reinstatement of a quarterly dividend. The first disbursement of this dividend paid in April of 2005 totaled \$7.7 million or \$.025 per common share.

We expect to receive approximately \$43.0 million in the second and third quarters of 2005 related to the collection of our note receivable resulting from the sale of our funeral operations in France in March 2004 and the redemption of other various preferred equity instruments. As of May 10, 2005, we have received EUR 27.3 million, or approximately \$35.0 million of the expected \$43.0 million, from this transaction. For more details related to this transaction, see note twelve to the consolidated financial statements.

We are continuing our program to divest of our operations outside of North America. In the first quarter of 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

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Singapore and cemetery businesses in Chile that we will look to exit when market values and economic conditions are conducive to a sale; however these businesses are not currently being held for sale. In addition, our improved financial condition and credit profile have allowed us to receive cash collateral previously pledged in connection with various commercial commitments. During the first quarter of 2005, we received \$9.3 million of such collateral. As of March 31, 2005, we have no cash pledged as collateral with surety companies.

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 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 reclassify 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 trust funded 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 trust funded preneed funeral contracts have not included a finance charge. However, we began test marketing of a finance charge for these contracts during the fourth quarter of 2004. We plan a phased roll-out during 2005 to the states where such finance charges are allowed on trust funded preneed funeral trust contracts.

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 the revised Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* (FIN 46R), the preneed funeral trust assets have been consolidated and are recorded in our

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consolidated balance sheet at market value in accordance with Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (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 this section of this amended Form 10-Q for additional information regarding the implementation of FIN 46R.

Prior to January 1, 2005, direct selling costs incurred pursuant to the sales of trust funded preneed funeral contracts were deferred and included in *Deferred charges and other assets* in the consolidated balance sheet. The deferred selling costs were 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) were expensed as incurred. An allowance for cancellation was recorded for trust funded preneed funeral contract deferred selling costs based on historical contract cancellation experience.

Beginning January 1, 2005, we have made an accounting change to expense all direct selling costs as incurred with the sales of preneed funeral contracts. See Critical Accounting Policies and Accounting Changes in this section of this amended Form 10-Q for additional information regarding this change in accounting for selling costs.

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 on behalf of 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 March 31, 2005 or December 31, 2004.

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 items *Net effect of preneed funeral production and maturities* and *Net income (loss)* in the consolidated statement of cash flows. While the contract is outstanding, cash flow is provided by the amount retained from funds collected from the customer and any distributed investment earnings. Prior to January 1, 2005, this was reduced by the payment of trust funded preneed funeral selling costs and the effect of amortizing trust funded preneed funeral deferred selling costs was reflected in *Depreciation and amortization* in the consolidated statement of cash flows. Effective January 1, 2005, the payment of direct selling expenses associated with trust funded preneed funeral contracts is reflected in the consolidated statement of cash flows as cash flows from operating activities in the line item *Net income (loss)*. 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 statements 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.

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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 items *Net effect of preneed funeral production and maturities* and *Net income (loss)* 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. 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. Refunds on customer cancellations of bonded contracts are also a reduction of working capital from operating activities reflected in the line item *Net effect of preneed funeral production and maturities*. Effective January 1, 2005, the payments of direct selling costs are included in the line item *Net income (loss)*. Prior to January 1, 2005, the payment of direct selling costs was included in the line item *Net effect of preneed funeral production and maturities* and the effect of amortizing the deferred selling costs was reflected in *Depreciation and amortization*. The premiums paid to the surety companies for the bond coverage are reflected in the line item *Net income (loss)* as a use of working capital.

Insurance Funded Preneed Funeral Contracts: Where permitted, customers may 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, as these contracts are not assets and liabilities as defined by Statement of Financial Accounting Concepts No. 6, *Elements in Financial Statements* .

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. 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 63% of our 2005 North America preneed funeral production is insurance funded preneed funeral contracts.

We receive general agency (GA) 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 (typically ranging between 11% and 16%) and are recognized as funeral revenues when the insurance purchase transaction between the customer and third party insurance provider is completed. GA commissions totaled \$6.7 million and \$8.0 million in the first quarter of 2005 and 2004, respectively. 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 cancellation occurs within the one year following the date of sale, our cash flow is reduced by the charge-back of GA revenues and overrides. When the funeral service is performed at death maturity, atneed funeral revenues and related accounts receivable are recorded for the services and merchandise included on the insurance funded preneed contracts, the increasing death benefit associated with the insurance policy, and any additional items purchased by the family.

Proceeds from the insurance policies are applied to satisfy the receivables due and any remaining funds due are collected from the

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family. The insurance proceeds (which include the increasing death benefit of approximately 1% per year) less the funds used to provide the funeral goods and services provide a net source of cash flow. There is no guarantee that the increasing insurance benefit will cover future increases in the cost of providing a price guaranteed funeral service, which could materially adversely affect our future cash flows, revenues, and profit margins.

The table below details the North America results of trust and insurance funded preneed funeral production for the three months ended March 31, 2005 and 2004, the total selling costs incurred to obtain the preneed arrangements. Total selling costs incurred to obtain the preneed arrangements include compensation and associated fringe benefits, facility expense, advertising and lead procurement costs, sales supplies expense, and other associated costs.

(In millions)	North America Funeral Three months ended March 31,	
	2005	2004
Preneed Production:		
Trust (including bonded)	\$ 32.1	\$ 26.6
Insurance (1)	54.5	64.4
Total	\$ 86.6	\$ 91.0
Total selling costs	\$ 19.1	\$ 19.5

(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 (including amounts related to *Non-controlling interest in funeral and cemetery trusts*) at March 31, 2005 and December 31, 2004. 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 March 31, 2005 and December 31, 2004. 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 cost and market values associated with funeral trust investments included in the assets associated with the backlog of trust funded deferred preneed funeral revenues at March 31, 2005 and December 31, 2004 are computed as follows. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds and private equity investments. Market reflects the fair market value of securities or cash held by the common trust funds, mutual funds at published values and the estimated market value of private equity investments (including debt as well as the estimated fair value related to the contract holders equity in majority-owned real estate investments). The market value of funeral trust investments was based primarily on quoted market prices at March 31, 2005 and December 31, 2004. 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.

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	North America Funeral			
	March 31, 2005 (Restated)		December 31, 2004 (Restated)	
	Market	Cost	Market	Cost
Backlog of trust funded deferred preneed funeral revenues (1)	\$ 1,456.0	\$ 1,454.7	\$ 1,475.9	\$ 1,440.8
Backlog of insurance funded preneed funeral revenues (2)	\$ 2,211.6	\$ 2,211.6	\$ 2,202.6	\$ 2,202.6
Total backlog of preneed funeral revenues (including bonded)	\$ 3,667.6	\$ 3,666.3	\$ 3,678.5	\$ 3,643.4
Assets associated with backlog of trust funded deferred preneed funeral revenues, net of estimated allowance for cancellation	\$ 1,145.8	\$ 1,144.4	\$ 1,165.8	\$ 1,130.6
Insurance policies associated with insurance funded deferred preneed funeral revenues, net of estimated allowance for cancellation (2)	\$ 2,211.6	\$ 2,211.6	\$ 2,202.6	\$ 2,202.6
Total assets associated with backlog of preneed funeral revenues	\$ 3,357.4	\$ 3,356.0	\$ 3,368.4	\$ 3,333.2

(1) Includes amounts reflected as *Non-controlling interest in funeral and cemetery trusts* in the consolidated balance sheet, net of estimated cancellation allowance.

(2) Insurance funded preneed funeral contracts are not included in the consolidated balance sheet.

Preneed Cemetery Activities

When purchasing cemetery property interment rights, merchandise, and services on a preneed basis, approximately 30% of our consumers choose to pay the entire amount of the contract at the time of sale. The remaining customers choose to pay for their contracts on an installment basis generally over a period of one to seven years. On these installment contracts, we receive an average down payment at the time of sale of approximately 14%. Historically, the installment contracts have included a finance charge ranging from 3.5% to 15.7% depending on the date sold, the payment period selected, state laws and the payment method (i.e., monthly statement billing or automated bank draft). Unlike trust funded preneed funeral contracts, where the entire purchase price is deferred and the revenue is recognized as one event at the time of death maturity, the revenues associated with a preneed cemetery contract can be recognized as different contract events occur. Preneed sales of cemetery interment rights (cemetery burial property) are recognized when a minimum of 10% of the sales price has been collected and the property has been constructed or is available for interment. With the customer's direction, which is generally obtained at the time of sale, we can choose to order, store, and transfer title to the customer of their personalized marker merchandise. Upon the earlier of vendor storage of these items or delivery in our cemetery, we recognize the associated revenues and record the cost of sale. For services, personalized marker merchandise where the customer chooses not to elect vendor storage or early delivery to our cemetery, and non-personalized merchandise (such as vaults), we defer the revenues until the services are performed and the merchandise is delivered.

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Because the services or merchandise will not be provided until some time in the future, all or a portion of the proceeds from the sale of preneed cemetery merchandise and services may be required by law to be paid into merchandise and services trusts until the merchandise is delivered or the service is provided. As with trust funded preneed funeral contracts, 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 as established by our Investment Committee of the Board of Directors. The trustees utilize professional investment advisors to select and monitor the money managers that make the 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. In certain situations pursuant to state or provincial laws, we post a surety bond as financial assurance for a certain amount of the preneed cemetery contract in lieu of placing funds into trust accounts. See the *Financial Assurances* section within this Preneed Funeral and Cemetery Activities section for further details on our practice of posting such surety bonds.

The trust investments are expected to generate earnings sufficient to offset the inflationary costs of providing the preneed cemetery 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 cemetery trust investments have been consolidated in our balance sheet and are recorded 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 item is delivered or cancelled. However, in certain states, the trustees are allowed to distribute a portion of the investment earnings to us before the preneed cemetery service or merchandise item is delivered (distributable states). Until delivered or cancelled, any investment earnings are attributed to the individual contract items. Recognition of the net investment earnings is independent of the timing of the receipt of the related cash flows, but generally will be the same in states that are not distributable states.

As a result of our 2003 restatement and other events including the implementation of Section 404 of the Sarbanes Oxley Act and the implementation of the new point-of-sale system, we began a process to examine all cemetery contracts in our deferred preneed cemetery contract balance to ensure that revenue was recognized in the appropriate period (when merchandise and services were delivered). As of May 2, 2005, we have completed our reconciliation procedures for our cemetery contracts and our results indicated no significant fluctuations from our expectations. Therefore, no adjustment in the first quarter was required.

Prior to January 1, 2005, direct selling costs incurred pursuant to the sales of preneed cemetery contracts were deferred and included in *Deferred charges and other assets* in the consolidated balance sheet. The deferred selling costs were expensed in proportion to the corresponding revenues when recognized. Other selling costs associated with the sales and marketing of preneed cemetery contracts (e.g., lead procurements costs, brochures and marketing materials, advertising and administrative costs) were expensed as incurred. An allowance for cancellation was recorded for cemetery deferred selling costs based on historical contract cancellation experience.

Beginning January 1, 2005, we made an accounting change to expense all direct selling costs as incurred with the sales of preneed cemetery contracts. See Critical Accounting Policies and Accounting Changes in Item 2 in this amended Form 10-Q for additional information regarding this change in accounting for selling costs.

If a preneed cemetery contract is cancelled prior to delivery, state or provincial law determines the amount of the refund owed to the customer, if any, including the amount of the attributed investment earnings. Upon cancellation, we receive the amount of principal deposited to trust and previously undistributed investment earnings and, where required, issue a refund to the customer. We retain any excess funds and recognize the attributed investment earnings (net of any investment earnings payable to the customer) in our consolidated statement of operations. Based on our historical experience, we have included an allowance for cancellation for preneed cemetery contracts in *Preneed cemetery receivables and trust investments* and *Deferred preneed cemetery revenues* in our consolidated balance sheet.

As the preneed cemetery contract merchandise and service items for which we were required to deposit funds to trust are delivered and recognized as revenues, we receive the principal and previously undistributed investment earnings from the trust. There is generally no remaining receivable due from the customer, as our policy is to deliver

preneed cemetery merchandise and service items only upon payment of the contract balance in full. This cash flow at delivery is generally less than the revenue recognized, thus creating a negative effect on working capital cash flow from operating activities, especially if we posted a surety bond in lieu of

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trusting for the preneed cemetery contract merchandise and service items, as there are no funds in trust available for withdrawal.

The cash flow activity from the date of sale of a preneed cemetery contract (origination) to the date of the recognition of the deferred revenue upon its delivery or cancellation (maturity) is reported in the *Net effect of cemetery production and deliveries* and *Net income (loss)* line items in the consolidated statement of cash flows. Net effect of preneed cemetery production and deliveries is affected by cash flows provided by the amount retained from funds collected from the customer and distributed trust earnings. Prior to January 1, 2005, this was reduced by the use of funds for the payment of trust funded preneed cemetery selling costs when the preneed cemetery contracts were originated.

The table below details the North America results of total cemetery sales production for the three months ended March 31, 2005 and 2004. Additionally, the table reflects previously deferred revenues recognized in the consolidated statements of operations associated with deliveries/services of cemetery contract items for the three months ended March 31, 2005 and 2004. The Company has conformed the data presented in 2004 on a pro forma basis to be consistent with the presentation of 2005.

(In millions)	North America Cemetery Three months ended March 31,	
	2005	2004 (Restated) Pro forma
Total preneed cemetery production	\$ 74.4	\$ 85.7
Total atneed cemetery production	54.8	47.6
Total cemetery sales production	129.2	133.3
Total selling costs	\$ 24.4	\$ 33.6

Subsequent to March 31, 2004, we refined our allocation of selling costs between the funeral and cemetery segments. This reallocation resulted in a decrease of selling costs to our cemetery segment.

The following table reflects the total North America backlog of *Deferred cemetery contract revenues* (including amounts related to *Non-controlling interests in funeral and cemetery trusts*) included in our consolidated balance sheet at March 31, 2005 and December 31, 2004. The backlog amount presented is reduced by an amount that we believe will cancel before maturity.

	North America Cemetery			
	March 31, 2005 (Restated)		December 31, 2004 (Restated)	
	Market	Cost	Market	Cost
Backlog of deferred cemetery revenues (including bonded) (1)	\$ 1,665.5	\$ 1,629.8	\$ 1,682.3	\$ 1,605.4
Assets associated with backlog of deferred cemetery revenues, net of estimated allowance for cancellation	\$ 1,205.0	\$ 1,174.0	\$ 1,237.4	\$ 1,170.8

- (1) Includes amounts reflected as *Non-controlling interest in funeral and cemetery trusts* in the consolidated balance sheet, net of estimated cancellation allowance.

Financial Assurances

In support of operations, we have entered into arrangements with certain surety companies whereby such companies agree to issue

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surety bonds on our behalf as financial assurance and/or as required by existing state and local regulations. The surety bonds are used for various business purposes; however, the majority of the surety bonds issued and outstanding have been used to support our preneed funeral and cemetery sales activities. The underlying obligations these surety bonds assure are recorded on the consolidated balance sheet as *Deferred preneed funeral revenues* and *Deferred preneed cemetery revenues*. The breakdown of surety bonds between funeral and cemetery preneed arrangements, as well as surety bonds for other activities is described below. The increase in preneed surety bonds for cemetery is primarily a result of the periodic review performed to adjust the bonds to cover the increased costs for liabilities associated with sales in prior years. We expect this number to decline in subsequent years as merchandise and services related to bonded contracts in Florida are delivered or performed (see further discussion related to Florida bonding below).

(In millions)	March 31, 2005	December 31, 2004
Preneed funeral	\$ 137.0	\$ 146.7
Preneed cemetery:		
Merchandise and services	193.2	186.7
Preconstruction	8.7	8.3
 Bonds supporting preneed funeral and cemetery obligations	 338.9	 341.7
 Bonds supporting preneed business permits	 5.0	 5.3
Other bonds	5.6	5.5
 Total surety bonds outstanding	 \$ 349.5	 \$ 352.5

When selling preneed funeral and cemetery contracts, we intend to post surety bonds where allowed by applicable law, except as noted below for Florida. We post the surety bonds in lieu of trusting a certain amount of funds received from the customer. The amount of the bond posted is generally determined by the total amount of the preneed contract that would otherwise be required to be trusted, in accordance with applicable state law.

Surety bond premiums are paid annually and are automatically renewable until maturity of the underlying preneed contracts, unless we are given prior notice of cancellation. Except for cemetery preconstruction bonds (which are irrevocable), the surety companies generally have the right to cancel the surety bonds at any time with appropriate notice. In the event a surety company was to cancel the surety bond, we are required to obtain replacement surety assurance from another surety company or fund a trust for an amount generally less than the posted bond amount. Management does not expect it will be required to fund material future amounts related to these surety bonds because of lack of surety capacity.

The applicable Florida law that allows posting of surety bonds for preneed contracts expired December 31, 2004; however, it allows for preneed contracts entered into prior to December 31, 2004 to continue to be bonded for the remaining life of those contracts. On February 1, 2004, we elected to begin trusting as a financial assurance mechanism in Florida, rather than surety bonding, on new Florida sales of preneed funeral and cemetery merchandise and services. Our net trust deposits required in 2004 for these two months of new Florida sales were \$1.2 million, while our net trust deposits required in 2005 for new Florida sales were \$4.0 million. The net deposits in the first quarter of 2004 only represented one month of cash receipts on one month of new sales, as deposits in Florida are made in the month following receipt of the cash. The net deposits in the first quarter of 2005 include amounts required for three months of receipts on all installment sales since we elected to begin trusting in February 2004, offset by the withdrawals for contracts delivered or cancelled.

Cautionary Statement on Forward-Looking Statements

The statements in this amended Form 10-Q that are not historical facts are forward-looking statements made in reliance on the safe harbor protections provided under the Private Securities Litigation Reform Act of 1995. These

statements may be accompanied by words such as believe, estimate, project, expect, anticipate or predict, that reflect the uncertainty of future events or outcomes. These statements are based on assumptions that we believe are reasonable; however, many important factors could cause our

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actual results in the future to differ materially from the forward-looking statements made herein and in any other documents or oral presentations made by us, or on our behalf. Important factors, which could cause actual results to differ materially from those in forward-looking statements include, among others, the following:

Changes in general economic conditions, both domestically and internationally, impacting financial markets (e.g., marketable security values, as well as currency and interest rate fluctuations) that could negatively affect us, particularly, but not limited to, levels of trust fund income, interest expense, pension expense and negative currency translation effects.

The outcomes of pending lawsuits and proceedings against us and the possibility that insurance coverage is deemed not to apply to these matters or that an insurance carrier is unable to pay any covered amounts to us.

Amounts payable by us with respect to our outstanding legal matters exceeding our established reserves.

We maintain accruals for tax liabilities which relate to uncertain tax matters. If these tax matters are unfavorably resolved, we will make any required payments to tax authorities. If these tax matters are favorably resolved, the accruals maintained by us will no longer be required and these amounts will be reversed through the tax provision at the time of resolution.

Our ability to successfully implement our strategic plan related to producing operating improvements and strong cash flows.

Our ability to successfully implement our plan to reduce costs and increase cash flows associated with significant changes being made to our organization structure, process and quality of our sales efforts.

Changes in consumer demand and/or pricing for our products and services due to several factors, such as changes in numbers of deaths, cremation rates, competitive pressures and local economic conditions.

Changes in domestic and international political and/or regulatory environments in which we operate, including potential changes in tax, accounting and trusting policies.

Changes in credit relationships impacting the availability of credit and the general availability of credit in the marketplace.

Our ability to successfully complete our ongoing process improvement projects, particularly related to the implementation of new processes and internal controls.

Our ability to successfully access surety and insurance markets at a reasonable cost.

Our ability to successfully exploit our substantial purchasing power with certain of our vendors.

The outcome of a pending Internal Revenue Service audit.

The effectiveness of our internal controls over financial reporting, and our ability to certify the effectiveness of the internal controls and to obtain a favorable attestation report of our auditors regarding our assessment of our internal controls.

For further information on these and other risks and uncertainties, see our Securities and Exchange Commission filings, including our 2004 Annual Report on Form 10-K, as amended. Copies of this document as well as other SEC filings can be obtained from our website at www.sci-corp.com. We assume no obligation to publicly update or revise any forward-looking statements made herein or any other forward-looking statements made by us, whether as a result

of new information, future events or otherwise.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

For information regarding our exposure to certain market risks, see Item 7A. Quantitative and Qualitative Disclosures about Market Risk in our current report on Form 10-K, as amended, for the year ended December 31, 2004. At March 31, 2005 and December 31, 2004, less than 1% of our net assets related to our equity investment in France after consummation of a joint venture transaction. There have been no other material changes to the disclosure on this matter made in such amended Form 10-K.

We occasionally use derivative instruments, primarily in the form of forward exchange contracts, to hedge our net investment in foreign assets and for other hedging activities. We do not participate in derivative transactions that are leveraged or considered speculative in nature. During the first quarter 2004, we executed certain forward exchange contracts as hedges of our net foreign investment in our France operations and related to our expected proceeds from the sale of a portion of our equity interest in and the prepayment of a note receivable from a United Kingdom company.

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As of March 31, 2005, the above derivative instruments had expired with the sale of France and the receipt of the proceeds from the United Kingdom. We were not a party to any derivative transactions at March 31, 2005.

Item 4. Controls and Procedures***Disclosure Controls and Procedures***

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's periodic Securities Exchange Act of 1934 reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required financial disclosure.

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's Disclosure Committee and management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon, and as of the date of this evaluation, such officers concluded that the Company's disclosure controls and procedures were not effective because of the material weaknesses described below. In light of the material weaknesses described below, the Company performed additional analysis and other post-closing procedures to ensure our consolidated financial statements are prepared in accordance with generally accepted accounting principles. Accordingly, management believes that the consolidated financial statements included in this report fairly present in all material respects our financial position, results of operations and cash flows for the periods presented.

Internal Control Over Financial Reporting (As Restated)

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is a process designed under the supervision of the Company's principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of the Company's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

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

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2004. In making this assessment, management used the criteria described in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

A material weakness is a control deficiency, or combination of control deficiencies, that results in a more than remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. We identified the following material weaknesses in our assessment of the effectiveness of internal control over financial reporting as of December 31, 2004:

- A. The Company did not maintain effective controls over the completeness of revenue recognition on preneed cemetery contracts. Specifically, the Company did not maintain effective controls over revenue recognition transactions associated with the timely recording of the physical delivery and performance of cemetery goods and services sold on a preneed basis. This control deficiency resulted in the restatement of the Company's 2004, 2003 and 2002 consolidated financial statements as well as its quarterly financial data for all quarters of both 2004 and 2003. Additionally, this control deficiency could result in the misstatement of cemetery merchandise and service revenues and of deferred revenues and assets associated with cemetery goods and services sold

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on a preneed basis that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.

- B. The Company did not maintain effective controls over the reconciliations of preneed funeral and cemetery detailed records to trust fund assets and corresponding deferred revenue and non-controlling interest accounts related to preneed funeral and cemetery activities, and of cemetery deferred selling costs. This control deficiency resulted in the restatement of the Company's 2004, 2003 and 2002 consolidated financial statements as well as its condensed consolidated financial statements for the first quarter of 2005 and quarterly financial data for all quarters of both 2004 and 2003. Additionally, this control deficiency could result in the misstatement of funeral and cemetery revenues and of assets and liabilities associated with preneed funeral and cemetery activities that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.
- C. The Company did not maintain effective controls over its application and monitoring of the appropriate accounting policies related to certain lease accounting. Specifically, the Company did not maintain effective controls over the application and monitoring of its accounting policies relating to lease renewal options and rent escalation provisions. This control deficiency contributed to the restatement of the Company's 2004, 2003 and 2002 consolidated financial statements as well as its quarterly financial data for all quarters of both 2004 and 2003. Additionally, this control deficiency could result in the misstatement of accrued rental liability and related operating rental expense that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.
- D. The Company did not maintain effective controls over the validity, accuracy and completeness over revenue recognition and deferred revenue from preneed and atneed funeral and cemetery contracts. Specifically, the Company did not maintain effective controls over the proper review of preneed and atneed funeral and cemetery contracts by local management, the proper review by location management for customer and authorized Company signatures and proper completion of customer contracts. This control deficiency did not result in an adjustment to the 2004 annual or interim financial statements. However, this control deficiency could result in a misstatement of revenues, accounts receivable and deferred revenue that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.
- E. The Company did not maintain effective controls over the use and control of pre-numbered manual contracts, and the accuracy of information pertaining to manual contracts entered into the Company's point-of-sale system over revenue and deferred revenue from preneed and atneed funeral and cemetery contracts. Specifically, manual contracts are not consistently controlled to ensure that revenues related to preneed and atneed funeral and cemetery manual contracts are reflected in the financial statements in the appropriate time period. Additionally, sales detail reports for atneed funeral and cemetery and preneed cemetery manual contracts are not consistently being reviewed by location personnel to ensure agreement between manual contract information and information entered into the point-of-sale system. This control deficiency did not result in an adjustment to the 2004 annual or interim financial statements. However, this control deficiency could result in a misstatement of revenue, accounts receivable and deferred revenues that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.
- F. The Company did not maintain effective controls over the accuracy, completeness and safeguarding of cash receipts. Specifically, individual cash receipt documentation is not consistently prepared for all cash or check payments made by the customer, daily

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reconciliations of cash are not consistently reviewed by location personnel and customer payments are not consistently secured at all times prior to deposit. This control deficiency did not result in an adjustment to the 2004 annual or interim financial statements. However, this control deficiency could result in misappropriation of Company assets and a misstatement of cash and accounts receivable that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.

- G. The Company did not maintain effective controls over the approval of adjustments to and review of collectability of atneed funeral and cemetery accounts receivable. Client families commonly request changes to items or services after the initial contract has been signed which requires adjustments to their contract and requires an adjustment to revenue and accounts receivable. The Company did not have effective controls over proper review by location management of adjustments to the customer revenue and accounts receivable related to such items or services or proper review of accounts receivable balances for reasonableness or collectability. Additionally, the Company did not have effective controls over review by location management of the outstanding account balances at period-end to ensure appropriate follow up is performed or write-off of account balance is performed. This control deficiency did not result in an adjustment to the 2004 annual or interim financial statements. However, this control deficiency could result in a misstatement of accounts receivable and revenues that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.
- H. The Company did not maintain effective controls over the review of cash disbursements at the funeral and cemetery locations. Specifically, the Company did not maintain effective controls over the review by location management of disbursements made at those locations and by the corporate office in Houston on behalf of such locations in order to verify that all expenditures are accurate and reasonable. This control deficiency did not result in an adjustment to the 2004 annual or interim financial statements. However, this control deficiency could result in expenditures being made that are erroneous or not for legitimate business purposes or could result in a misstatement of accounts payable or expenses that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.
- I. The Company did not maintain effective controls over the existence, completeness and accuracy of merchandise inventory. Specifically, the Company did not maintain effective controls over physical inventory counts at the funeral and cemetery locations. Inventory count sheets were not signed by individuals who performed and verified the counts. Also, in some instances, inventory counts were not conducted on a timely basis or the inventory counts by location personnel were not accurate. This control deficiency did not result in an adjustment to the 2004 annual or interim consolidated financial statements. However, this control deficiency could result in the misstatement of inventory and cost of sales that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.
- J. The Company did not maintain effective controls over the accounting for capitalized covenant-not-to-compete agreements and the recording of asset impairments and divestitures related to the sale or disposition of locations in accordance with generally accepted accounting principles. Specifically, the Company failed to write off certain previously capitalized covenant-not-to-compete assets resulting in a misstatement of the gain or loss upon exiting locations and the ongoing amortization expense. Additionally, the Company did not maintain effective controls over the impairment or disposition of assets related to the sale of certain locations in the proper period. This control deficiency resulted in the restatement of the Company's 2004, 2003 and 2002 consolidated financial statements, as well as its condensed consolidated financial statements for the first quarter of 2005 and quarterly financial data for all quarters of both 2004 and 2003. Furthermore, this control deficiency could result in the misstatement of gains and impairment (losses) on dispositions, property, plant and equipment and deferred charges

and other assets that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.

- K. The Company did not maintain effective controls over its information technology program change control procedures with respect to the Company's point-of-sale system (HMIS) and associated interfaces. Specifically, the Company did not maintain effective controls to assess the impact of HMIS program changes to related interfaces and to adequately test the accuracy and performance of such program changes. This control deficiency contributed to the material weaknesses and restatement described in (B) and (L) herein. Additionally, this control deficiency could result in the

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misstatement of funeral revenues and of assets and liabilities associated with preneed funeral activities that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.

L. The Company did not maintain effective controls over the accuracy of preneed funeral trust income recorded upon the maturity of certain preneed funeral contracts. Specifically, the Company did not maintain effective controls over the posting of automated journal entries to the general ledger resulting in the entries being posted to the incorrect account. This control deficiency resulted in the restatement of the Company's 2004 financial statements including an adjustment to the fourth quarter 2004 financial data as well as its condensed consolidated financial statements for the first quarter of 2005. Additionally, this control deficiency could result in the misstatement of funeral revenues and of assets and liabilities associated with preneed funeral activities that would result in a material misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.

M. The Company did not maintain effective controls over the communication and evaluation by the legal department of information related to legal claims. Specifically, the legal department did not communicate information relevant to the complete and accurate recording of legal accruals in the proper period in accordance with generally accepted accounting principles. This control deficiency did not result in an adjustment to the Company's 2004 consolidated financial statements or first quarter 2005 condensed consolidated financial statements. However, this control deficiency did result in an adjustment detected by the auditor to the second quarter 2005 condensed consolidated financial statements. Additionally, this control deficiency could result in the misstatement of general and administrative expenses and accrued liabilities that would result in a misstatement to annual or interim financial statements that would not be prevented or detected. Accordingly, management determined that this control deficiency represents a material weakness.

Because of these material weaknesses, we concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2004 based on the criteria in the *Internal Control - Integrated Framework* issued by the COSO. The above described material weaknesses continue to exist as of March 31, 2005.

Management had previously concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2004 because of the material weaknesses described in (A) - (M) above. In connection with the restatement of the Company's interim financial data described in note two, management has determined that the restatement was an additional effect of the material weaknesses described in (B), (J), (K), and (L) above that were previously disclosed in Item 9A of the Company's 2004 Form 10-K/A (Amendment No. 2). Accordingly, this restatement did not have an effect on this report on internal control over financial reporting.

Status of Plan for Remediation

Management, with the oversight of the Audit Committee, has been aggressively addressing all of the above deficiencies and is committed to effectively remediating known weaknesses in our internal control over financial reporting and disclosure controls and procedures as expeditiously as possible. We have devoted significant time and resources to remediate the deficiencies identified.

We previously initiated projects to reconcile our preneed backlog detailed records to trust assets and corresponding liabilities. These reconciliation projects involved examining the contract details for the individual preneed funeral trust contracts and undelivered cemetery contracts in our detail accounting system records against the manual contract files in the individual funeral homes and cemeteries. We then reconciled the adjusted detail accounting system records to the general ledger balances and recorded any required adjustments. For the related trust assets, we reconciled the contract detail balances to the related trustee bank statements and the general ledger balances. The Company has completed these examination projects and implemented the reconciliation procedures

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as described above, which resulted in the identification of a significant number of reconciling items. Subsequent to the completion of the examination of the contracts, the Company began recording the reconciling items to the trust asset and deferred revenue detailed records. During this review, the Company determined that certain of the reconciling items had been reflected improperly in its initial review which resulted in an error to the Company's consolidated financial statements. However, we have further strengthened the internal controls and procedures surrounding the reconciliation process and anticipate that these internal controls will be operating effectively for the current reconciliations by the end of 2005.

The Company is currently developing control procedures to ensure lease payments and related asset depreciation are expensed in accordance with generally accepted accounting principles. We expect these procedures to be completed during 2005.

We currently rely on processes that are heavily dependent on manual and detective controls and on human intervention at our funeral and cemetery locations. Many of the funeral and cemetery location controls are widely dispersed across the Company's network of approximately 1,600 locations making it very difficult to achieve a consistently high level of precision. In May 2005 we implemented the following additional redundant, compensating, and monitoring controls at a consolidated level to monitor the control activities performed at the funeral and cemetery locations.

Review of preneed and atneed funeral and cemetery contracts to verify location management approval.

Review of manual contract control logs at funeral and cemetery locations to verify completeness of contracts issued.

Review of manual contracts to verify the accuracy of data entered into the point-of-sale system.

Review of daily cash receipts and cash report reconciliations at the funeral and cemetery locations to verify accuracy and performance.

Review of revenue recognition transactions at cemetery locations to verify accuracy of the delivery and performance of cemetery goods and services which were previously sold on a preneed basis.

Verification of approvals of accounts receivable adjustments at funeral and cemetery locations.

Verification of reviews of cash disbursement reports at funeral and cemetery locations.

These additional controls and procedures will provide us with greater visibility over the performance of the controls in the funeral and cemetery locations. We will continue with formal training at the funeral and cemetery locations and continually assess the effectiveness of controls. Additionally, we are also planning for longer-term improvements in key business processes with an emphasis on preventative controls (versus detective controls), and system-based controls (versus manual controls) wherever possible.

We believe our consolidated financial statements present fairly the financial position of the Company and do not contain any material misstatements. The above described material weaknesses in internal control over financial reporting if left unremediated increase the likelihood of misstatements occurring in future periods and not being detected in a timely manner.

Changes in Internal Control Over Financial Reporting

The component of the material weakness noted above related to the reconciliation of cemetery deferred selling costs is no longer applicable due to the Company's change in accounting for direct selling costs effective January 1, 2005 whereby all deferred selling costs were expensed as a change in accounting and all future direct selling costs are expensed when incurred, eliminating the requirement to reconcile deferred selling costs. Please see note four to the Company's interim consolidated financial statements for more information related to this accounting change. Except as otherwise discussed herein, there have been no changes in the Company's internal control over financial reporting during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially

affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Table of Contents**Item 1. Legal Proceedings**

Information regarding legal proceedings is set forth in note nine to the unaudited consolidated financial statements in Item 1 of Part I of this amended Form 10-Q which information is hereby incorporated by reference herein.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

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 totaling \$7.7 million was paid 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.

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 and February 10, 2005, we announced two increases in the share repurchase program each authorizing the investment of up to an additional \$100 million to repurchase our common stock for an aggregate of \$300 million. Pursuant to the program, we have repurchased shares of our common stock as set forth in the table below. As of March 31, 2005, the purchases totaled \$213.8 million.

		Issuer purchases of equity securities			
		(a)	(b)	(c)	(d)
Period		Total	Total number of shares purchased as part of publicly announced programs		Dollar value of shares that may yet be purchased under the programs
		number of shares purchased	Average price paid per share		
January 1, 2005	January 31, 2005	10,863,863	\$ 7.00	10,863,863	\$ 13,483,247
February 1, 2005	February 28, 2005	3,623,200	\$ 7.18	3,623,200	\$ 87,380,214
March 1, 2005	March 31, 2005	163,000	\$ 7.39	163,000	\$ 86,171,928
		14,650,063	\$ 7.05	14,650,063	\$ 86,171,928

From April 1, 2005 to May 16, 2005, we repurchased 5.5 million shares for a total cost of \$39.6 million. As of May 16, 2005, the remaining dollar value of shares that may yet be purchased under our share repurchase programs was approximately \$46.6 million.

Item 6. Exhibits

10.1 Agreement and First Amendment to Amended and Restated Credit Agreement among the Company, as Borrower, the lenders party thereto, JPMorgan Chase Bank, National Association, as Administrative Agent, Bank of America, N.A., as Syndication Agent, and Calyon New York Branch, Amegy Bank, National Association and Merrill Lynch Capital Corporation, as Co-Documentation Agents, and JPMorgan Chase Banks National Association, as Administrative Agent.

12.1 Ratio of earnings to fixed charges for the three months ended March 31, 2005 and 2004.

18.1 Preferability letter from Independent Registered Public Accounting Firm (PricewaterhouseCoopers LLP) regarding change in accounting principle. (Incorporated by reference to Exhibit 18.1 to Form 10-Q for the quarterly period ended March 31, 2005).

- 31.1 Certification of Thomas L. Ryan as Chief Executive Officer in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Jeffrey E. Curtiss as Principal Financial Officer in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002.

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32.1 Certification of Periodic Financial Reports by Thomas L. Ryan as Chief Executive Officer in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Periodic Financial Reports by Jeffrey E. Curtiss as Principal Financial Officer in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002.

Undertaking

We hereby undertake, pursuant to Regulation S-K, Item 601(b), paragraph (4) (iii), to furnish to the U.S. Securities and Exchange Commission, upon request, all constituent instruments defining the rights of holders of our long-term debt not filed herewith for the reason that the total amount of securities authorized under any of such instruments does not exceed 10 percent of our total consolidated assets.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

October 27, 2005

SERVICE CORPORATION INTERNATIONAL

By: /s/ Jeffrey E. Curtiss

Jeffrey E. Curtiss
Senior Vice President Chief Financial Officer and
Treasurer (Principal Financial Officer)

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Index to Exhibits

Exhibits Description

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