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

FORM 10-Q

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

For the quarterly period ended September 30, 2018

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 its charter)

Texas

(State or other jurisdiction of incorporation or organization)

74-1488375

(I. R. S. employer identification number)

1929 Allen Parkway, Houston, Texas

(Address of principal executive offices)

77019

(Zip code)

713-522-5141

(Registrant's telephone number, including area code)

None

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

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). YES  NO

The number of shares outstanding of the registrant's common stock as of October 26, 2018 was 180,951,466 (net of treasury shares).

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SERVICE CORPORATION INTERNATIONAL

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## GLOSSARY

The following terms are common to the deathcare industry, are used throughout this report, and have the following meanings:

**Atneed** — Funeral, including cremation, and cemetery arrangements sold once death has occurred.

**Cancellation** — Termination of a preneed contract, which relieves us of the obligation to provide the goods and services included in the contract. Cancellations may be requested by the customer or be initiated by us for failure to comply with the contractual terms of payment. State or provincial laws govern the amount of refund, if any, owed to the customer.

**Care Trust Corpus** — The deposits and net realized capital gains and losses included in a perpetual care trust that cannot be withdrawn. In certain states, some or all of the net realized capital gains can be distributed, so they are not included in the corpus.

**Cemetery Merchandise and Services** — Stone and bronze memorials, markers, outer burial containers, floral placement, graveside services, merchandise installations, urns, and interments.

**Cemetery Perpetual Care Trust or Endowment Care Fund (ECF)** — A trust fund established for the purpose of maintaining cemetery grounds and property into perpetuity. For these trusts, the corpus remains in the trust in perpetuity and the investment earnings or elected distributions are withdrawn regularly and are intended to defray our expenses incurred to maintain the cemetery. In certain states, some or all of the net realized capital gains can also be distributed. Additionally, some states allow a total return distribution that may contain elements of income, capital appreciation, and principal.

**Cemetery Property** — Developed lots, lawn crypts, mausoleum spaces, niches, and cremation memorialization property items (constructed and ready to accept interments) and undeveloped land we intend to develop for the sale of interment rights. Includes the construction-in-progress balance during the pre-construction and construction phases of projects creating new developed property items.

**Cemetery Property Amortization** — The non-cash recognized expenses of cemetery property interment rights, which are recorded by specific identification with the cemetery property revenue for each contract.

**Cemetery Property Interment Rights** — The exclusive right to determine the human remains that will be interred in a specific cemetery property space. See also Cemetery Property Revenue below.

**Cemetery Property Revenue** — Recognized sales of interment rights in cemetery property when the receivable is deemed collectible and the property is fully constructed and available for interment.

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

**Cremation Memorialization** — Products specifically designed to commemorate and honor the life of an individual that has been cremated. These products include cemetery property items that provide for the disposition of cremated remains within our cemeteries such as benches, boulders, statues, etc. They also include memorial walls and books where the name of the individual is inscribed but the remains have been scattered or kept by the family.

**Funeral Merchandise and Services** — Merchandise such as burial caskets and related accessories, outer burial containers, urns and other cremation receptacles, casket and cremation memorialization products, flowers, and professional services relating to funerals including arranging and directing services, use of funeral facilities and motor vehicles, removal, preparation, embalming, cremations, memorialization, visitations, and catering.

**Funeral Recognized Preneed Revenue** — Funeral merchandise and travel protection, net sold on a preneed contract and delivered before a death has occurred.

**Funeral Services Performed** — The number of funeral services, including cremations, provided after the date of death, sometimes referred to as funeral volume.

**General Agency (GA) Revenue** — Commissions we receive from third-party life insurance companies for life insurance policies sold to preneed customers for the purpose of funding preneed funeral arrangements. The commission rate paid is determined based on the product type sold, the length of payment terms, and the age of the insured/annuitant.

**Interment** — The burial or final placement of human remains in the ground (interment), in mausoleums (entombment), in niches (inurnment), or in cremation memorialization property (inurnment).

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

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

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

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

**Merchandise and Service Trust** — A trust account established in accordance with state or provincial law into which we deposit the required percentage of customers' payments for preneed funeral, cremation, or cemetery merchandise and services to be delivered or performed by us in the future. The amounts deposited can be withdrawn only after we have completed our obligations under the preneed contract or the cancellation of the contract. Also referred to as a preneed trust.

**Outer Burial Container** — A reinforced container intended to inhibit the subsidence of the earth and house the casket after it is placed in the ground, also known as a burial vault.

**Preneed** — Purchase of cemetery property interment rights or any merchandise and services prior to death occurring.

**Preneed Backlog** — Future revenue from unfulfilled preneed funeral, cremation, and cemetery contractual arrangements.

**Preneed Cemetery Production** — Sales of preneed cemetery contracts. These sales are recorded in *Deferred revenue, net* until the merchandise is delivered, the service is performed, and the property has been constructed and is available for interment.

**Preneed Funeral Production** — Sales of preneed funeral trust-funded and insurance-funded contracts. Preneed funeral trust-funded contracts are recorded in *Deferred revenue, net* until the merchandise is delivered or the service is performed. We do not reflect the unfulfilled insurance-funded preneed funeral contract amounts in our Consolidated Balance Sheet. The proceeds of the life insurance policies will be reflected in revenue as these funerals are performed by us in the future.

**Preneed Receivables, Net** — After adoption of "*Revenue from Contracts with Customers*" on January 1, 2018, represents amounts due from customers when we have delivered the merchandise, performed the service, or transferred control of the cemetery property interment rights prior to a death occurring or amounts due from customers on irrevocable preneed contracts. Prior to adoption, represents all amounts due from customers on preneed contracts.

**Sales Average** — Average revenue per funeral service performed, excluding the impact of funeral recognized preneed revenue, GA revenue, and certain other revenue.

**Travel Protection** — A product that provides shipment of remains to the servicing funeral home or cemetery of choice if the purchaser passes away outside of a certain radius of their residence, without any additional expense to the family.

**Trust Fund Income** — Recognized investment earnings from our merchandise and service and perpetual care trust investments.

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

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

**SERVICE CORPORATION INTERNATIONAL**  
**CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS**  
**(UNAUDITED)**

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
(In thousands, except per share amounts)				
<b>Revenue:</b>				
Property and merchandise revenue	\$ 392,410	\$ 363,934	\$ 1,158,224	\$ 1,116,551
Service revenue	323,246	319,810	1,035,794	1,012,631
Other revenue	63,130	47,602	175,342	153,116
<b>Total revenue</b>	<b>778,786</b>	<b>731,346</b>	<b>2,369,360</b>	<b>2,282,298</b>
<b>Costs and expenses:</b>				
Cost of property and merchandise	(203,349)	(189,818)	(600,997)	(588,370)
Cost of service	(188,893)	(179,924)	(568,034)	(546,978)
Overhead and other expenses	(220,374)	(211,828)	(650,270)	(636,417)
<b>Total costs and expenses</b>	<b>(612,616)</b>	<b>(581,570)</b>	<b>(1,819,301)</b>	<b>(1,771,765)</b>
<b>Operating profit</b>	<b>166,170</b>	<b>149,776</b>	<b>550,059</b>	<b>510,533</b>
General and administrative expenses	(41,070)	(38,992)	(106,990)	(121,644)
Gains (losses) on divestitures and impairment charges, net	7,970	(143)	15,317	5,545
Hurricane expenses, net	(767)	(1,290)	(437)	(1,290)
<b>Operating income</b>	<b>132,303</b>	<b>109,351</b>	<b>457,949</b>	<b>393,144</b>
Interest expense	(46,419)	(42,754)	(134,514)	(125,473)
Loss on early extinguishment of debt, net	—	—	(10,131)	—
Other income (expense), net	152	(19)	2,416	(1,049)
<b>Income before income taxes</b>	<b>86,036</b>	<b>66,578</b>	<b>315,720</b>	<b>266,622</b>
(Provision for) benefit from income taxes	(17,043)	(10,437)	(61,398)	32,830
<b>Net income</b>	<b>68,993</b>	<b>56,141</b>	<b>254,322</b>	<b>299,452</b>
Net (income) loss attributable to noncontrolling interests	(58)	23	(160)	(105)
<b>Net income attributable to common stockholders</b>	<b>\$ 68,935</b>	<b>\$ 56,164</b>	<b>\$ 254,162</b>	<b>\$ 299,347</b>
<b>Basic earnings per share:</b>				
Net income attributable to common stockholders	\$ 0.38	\$ 0.30	\$ 1.39	\$ 1.59
Basic weighted average number of shares	180,858	187,435	182,859	187,761
<b>Diluted earnings per share:</b>				
Net income attributable to common stockholders	\$ 0.37	\$ 0.29	\$ 1.36	\$ 1.56
Diluted weighted average number of shares	185,460	192,243	187,517	192,417
Dividends declared per share	\$ 0.17	\$ 0.15	\$ 0.51	\$ 0.43

(See notes to unaudited condensed consolidated financial statements)

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
	(In thousands)			
Net income	\$ 68,993	\$ 56,141	\$ 254,322	\$ 299,452
Other comprehensive income:				
Foreign currency translation adjustments	5,951	16,580	(9,550)	30,185
Total comprehensive income	74,944	72,721	244,772	329,637
Total comprehensive income attributable to noncontrolling interests	(59)	14	(157)	(121)
Total comprehensive income attributable to common stockholders	<u>\$ 74,885</u>	<u>\$ 72,735</u>	<u>\$ 244,615</u>	<u>\$ 329,516</u>

(See notes to unaudited condensed consolidated financial statements)

**SERVICE CORPORATION INTERNATIONAL**  
**CONDENSED CONSOLIDATED BALANCE SHEET**  
**(UNAUDITED)**

	September 30, 2018	December 31, 2017
	(In thousands, except share amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 158,301	\$ 330,039
Receivables, net	84,018	90,304
Inventories	26,061	25,378
Other	32,107	35,575
Total current assets	<u>300,487</u>	<u>481,296</u>
Preneed receivables, net and trust investments	4,568,470	4,778,842
Cemetery property	1,835,761	1,791,989
Property and equipment, net	1,960,329	1,873,044
Goodwill	1,854,167	1,805,981
Deferred charges and other assets	954,478	601,184
Cemetery perpetual care trust investments	1,596,542	1,532,167
Total assets	<u>\$ 13,070,234</u>	<u>\$ 12,864,503</u>
<b>LIABILITIES &amp; EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 482,357	\$ 489,172
Current maturities of long-term debt	68,806	337,337
Income taxes payable	3,726	2,470
Total current liabilities	<u>554,889</u>	<u>828,979</u>
Long-term debt	3,542,314	3,135,316
Deferred revenue, net	1,431,181	1,789,776
Deferred tax liability	372,929	283,765
Other liabilities	402,593	410,982
Deferred receipts held in trust	3,687,394	3,475,430
Care trusts' corpus	1,589,948	1,530,818
Commitments and contingencies (Note 9)		
Equity:		
Common stock, \$1 per share par value, 500,000,000 shares authorized, 193,556,602 and 191,935,647 shares issued, respectively, and 180,933,966 and 186,614,747 shares outstanding, respectively	180,934	186,615
Capital in excess of par value	962,041	970,468
Retained earnings	313,720	210,364
Accumulated other comprehensive income	32,167	41,943
Total common stockholders' equity	<u>1,488,862</u>	<u>1,409,390</u>
Noncontrolling interests	124	47
Total equity	<u>1,488,986</u>	<u>1,409,437</u>
Total liabilities and equity	<u>\$ 13,070,234</u>	<u>\$ 12,864,503</u>

(See notes to unaudited condensed consolidated financial statements)

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

	Nine Months Ended	
	September 30,	
	2018	2017
	(In thousands)	
<b>Cash flows from operating activities:</b>		
Net income	\$ 254,322	\$ 299,452
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on early extinguishment of debt	10,131	—
Depreciation and amortization	117,496	113,641
Amortization of intangibles	20,170	20,923
Amortization of cemetery property	47,509	46,533
Amortization of loan costs	4,531	4,344
Provision for doubtful accounts	6,522	6,846
Provision for (benefit from) deferred income taxes	25,491	(148,465)
Gains on divestitures and impairment charges, net	(15,317)	(5,545)
Gain on sale of investments	(2,636)	—
Share-based compensation	11,740	10,719
Change in assets and liabilities, net of effects from acquisitions and divestitures:		
(Increase) decrease in receivables	(964)	12,568
Increase in other assets	(19,251)	(15,814)
(Decrease) increase in payables and other liabilities	(2,879)	66,455
Effect of preneed sales production and maturities:		
Increase in preneed receivables, net and trust investments	(37,387)	(58,631)
Increase in deferred revenue, net	43,329	37,438
Decrease in deferred receipts held in trust	(10,541)	(981)
Net cash provided by operating activities	452,266	389,483
<b>Cash flows from investing activities:</b>		
Capital expenditures	(165,943)	(141,652)
Acquisitions, net of cash acquired	(187,616)	(75,818)
Proceeds from divestitures and sales of property and equipment	29,890	32,588
Proceeds from sale of investments	2,900	—
Payments for Company-owned life insurance policies	(14,283)	(6,189)
Proceeds from Company-owned life insurance policies	2,810	2,591
Purchase of land and other	(14,525)	175
Net cash used in investing activities	(346,767)	(188,305)
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of long-term debt	395,000	120,000
Scheduled payments of debt	(25,601)	(26,376)
Early payments of debt	(259,590)	—
Principal payments on capital leases	(29,771)	(40,509)
Proceeds from exercise of stock options	18,481	30,672
Purchase of Company common stock	(275,726)	(148,818)
Payments of dividends	(93,002)	(80,711)
Purchase of noncontrolling interest	—	(4,580)
Bank overdrafts and other	(8,842)	2,790
Net cash used in financing activities	(279,051)	(147,532)
Effect of foreign currency on cash, cash equivalents, and restricted cash	(1,111)	9,463
Net (decrease) increase in cash, cash equivalents, and restricted cash	(174,663)	63,109
Cash, cash equivalents, and restricted cash at beginning of period	340,601	211,506
Cash, cash equivalents, and restricted cash at end of period	\$ 165,938	\$ 274,615



(See notes to unaudited condensed consolidated financial statements)

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

	Common Stock	Treasury Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total
Balance at December 31, 2017	\$ 191,936	\$ (5,321)	\$ 970,468	\$ 210,364	\$ 41,943	\$ 47	\$ 1,409,437
Cumulative effect of accounting changes	—	—	—	172,461	(229)	—	172,232
Comprehensive income	—	—	—	254,162	(9,547)	157	244,772
Dividends declared on common stock (\$0.51 per share)	—	—	—	(93,002)	—	—	(93,002)
Employee share-based compensation earned	—	—	11,740	—	—	—	11,740
Stock option exercises	1,340	—	17,141	—	—	—	18,481
Restricted stock awards, net of forfeitures	178	—	(178)	—	—	—	—
Purchase of Company common stock	—	(7,302)	(38,159)	(230,265)	—	—	(275,726)
Noncontrolling interest payments	—	—	—	—	—	(80)	(80)
Other	103	—	1,029	—	—	—	1,132
Balance at September 30, 2018	<u>\$ 193,557</u>	<u>\$ (12,623)</u>	<u>\$ 962,041</u>	<u>\$ 313,720</u>	<u>\$ 32,167</u>	<u>\$ 124</u>	<u>\$ 1,488,986</u>

(See notes to unaudited condensed consolidated financial statements)

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

**1. Nature of Operations**

We are North America's largest provider of deathcare products and services, with a network of funeral service locations and cemeteries operating in the United States and Canada. Our funeral service and cemetery operations consist of funeral service locations, cemeteries, funeral service/cemetery combination locations, crematoria, and other related businesses, which enable us to serve a wide array of customer needs. We sell cemetery property and funeral and cemetery merchandise and services at the time of need and on a preneed basis.

Funeral service locations provide all professional services relating to funerals and cremations, including the use of funeral facilities and motor vehicles, arranging and directing services, removal, preparation, embalming, cremations, memorialization, travel protection, and catering. Funeral merchandise, including burial caskets and related accessories, urns and other cremation receptacles, outer burial containers, flowers, online and video tributes, stationery products, casket and cremation memorialization products, and other ancillary merchandise, is sold at funeral service locations.

Our cemeteries provide cemetery property interment rights, including developed lots, lawn crypts, mausoleum spaces, niches, and other cremation memorialization and interment options. Cemetery merchandise and services, including memorial markers and bases, outer burial containers, flowers and floral placement, other ancillary merchandise, graveside services, merchandise installation, and interments, are sold at our cemeteries.

**2. Summary of Significant Accounting Policies**

***Principles of Consolidation and Basis of Presentation***

Our unaudited condensed consolidated financial statements include the accounts of Service Corporation International (SCI) and all subsidiaries in which we hold a controlling financial interest. Our financial statements also include the accounts of the merchandise and service trusts and cemetery perpetual care trusts in which we have a variable interest and are the primary beneficiary. Our interim condensed consolidated financial statements are unaudited but include all adjustments, consisting of normal recurring accruals and any other adjustments, which management considers necessary for a fair statement of our results for these periods. Our unaudited condensed consolidated financial statements have been prepared in a manner consistent with the accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2017, unless otherwise disclosed herein, and should be read in conjunction therewith. The accompanying year-end Condensed Consolidated Balance Sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year period.

***Reclassifications to Prior Period Financial Statements and Adjustments***

Certain reclassifications have been made to prior period amounts to conform to the current period financial statement presentation with no effect on our previously reported results of operations, consolidated financial position, or cash flows except as described below under "*Accounting Standards Adopted in 2018*".

***Use of Estimates in the Preparation of Financial Statements***

The preparation of the unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions as described in our Annual Report on Form 10-K for the year ended December 31, 2017. These estimates and assumptions may affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. As a result, actual results could differ from these estimates.

***Funeral and Cemetery Operations***

Revenue is recognized when control of the merchandise or services is transferred to the customer. Our performance obligations include the delivery of funeral and cemetery merchandise and services and cemetery property interment rights. Control transfers when merchandise is delivered or services are performed. For cemetery property interment rights, control transfers to the customer when the property is developed and the interment right has been sold and can no longer be marketed or sold to another customer. Sales taxes collected are recognized on a net basis in our consolidated financial statements.

On our atneed contracts, we generally deliver the merchandise and perform the services at the time of need. Personalized marker merchandise and marker installation services sold on atneed contracts are recognized when control is transferred to the customer, generally when the marker is delivered and installed in the cemetery, which occurs on the same day.

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We also sell price-guaranteed preneed contracts through various programs providing for future merchandise and services at prices prevailing when the agreements are signed. Revenue associated with sales of preneed contracts is deferred until control of the merchandise or the services is transferred to the customer, which is upon delivery of the merchandise or as services are performed, generally at the time of need.

On certain preneed contracts, we sell memorialization merchandise, which consists of urns and urn-related products, that we deliver to the customer at the time of sale. Revenue is recognized at the time of delivery when control of the memorialization merchandise is transferred.

For personalized marker merchandise sold on a preneed contract, we will:

- purchase the merchandise from vendors,
- personalize such merchandise in accordance with the customer's specific written instructions,
- either store the merchandise at a third-party bonded storage facility or install the merchandise, based on the customer's instructions, and
- transfer title to the customer.

We recognize revenue and record the cost of sales when control is transferred for the merchandise, which occurs upon delivery to the third-party storage facility or installation of the merchandise at the cemetery.

There is no general right of return for delivered items.

We also sell travel protection as an agent of a third party. Travel protection is a service that provides shipment of remains to the servicing funeral home or cemetery of choice if the purchaser passes away outside of a certain radius of their residence, without any additional expense to the family. We do not provide travel protection services and we are not primarily obligated to provide such services under these arrangements. Therefore, we record revenues, net of amounts due to these parties, at the time of sale.

Total consideration received for price-guaranteed preneed and for atneed contracts with customers represents the stated amount of the contract excluding any amounts collected on behalf of third parties, such as sales taxes. The total consideration received for contracts with customers is allocated to each performance obligation based on relative selling price. Relative selling prices are determined by either the amount we sell the performance obligation for on a stand-alone basis or our best estimate of the amount we would sell it for based on an adjusted market assessment approach that is consistent with our historical pricing practices.

Payment on atneed contracts is generally due at the time the merchandise is delivered or the services are performed. For preneed contracts, payment generally occurs prior to our fulfillment of the performance obligations. Our preneed contracts may also have extended payment terms with associated financing charges. Pursuant to state or provincial law, all or a portion of the proceeds from merchandise or services sold on a preneed basis may be required to be deposited into trust funds. When we receive payments from the customer, we deposit the amount required by law into the merchandise and service trusts and reclassify the corresponding amount from *Deferred revenue, net* into *Deferred receipts held in trust*. Amounts are withdrawn from the merchandise and service trusts when we fulfill the performance obligations. Earnings on these trust funds, which are specifically identifiable for each performance obligation, are also included in total consideration. We defer these investment earnings related to the merchandise and service trusts until the associated merchandise is delivered or services are performed. Fees charged by our wholly-owned registered investment advisor are also included in revenue in the period in which they are earned. In addition, we are entitled to retain, in certain jurisdictions, a portion of collected customer payments when a customer cancels a preneed contract; these amounts are also recognized in revenue.

A portion of the proceeds from the sale of cemetery property interment rights is required by state or provincial law to be paid into perpetual care trust funds by us to maintain the cemetery. This portion of the proceeds is not recognized as revenue. Investment earnings from these trusts are distributed to us regularly and recognized in current cemetery revenue. These distributions are intended to defray cemetery maintenance costs incurred by us for our owned cemetery properties, which are expensed as incurred. The principal of such perpetual care trust funds generally cannot be withdrawn; however, in lieu of the distribution of realized income, certain states allow a unitrust distribution which may contain elements of income, capital appreciation, and principal.

Costs related to delivery or performance of merchandise and services are charged to expense when merchandise is delivered or services are performed. Costs related to property interment rights include the property and construction costs specifically identified by each project. Property and construction costs are charged to expense when the revenue is recognized by specific identification in the performance of a contract. Incremental direct selling costs are deferred and recognized when the associated performance obligation is fulfilled based on specific identification in the fulfillment of a contract. All other selling costs are expensed as incurred.

As of September 30, 2018, we had \$281.7 million in deferred incremental direct selling costs included in *Deferred charges and other assets*. These deferred costs are classified as long-term on our Condensed Consolidated Balance Sheet because we do not control the timing of the delivery of the merchandise or performance of the services as they are generally provided at the

time of need. Such amounts are recognized based upon specific identification when the related performance obligations are delivered.

#### **Insurance-funded preneed contracts**

Not included in our Condensed Consolidated Balance Sheet are insurance-funded preneed contracts that will be funded by life insurance or annuity contracts issued by third party insurers. Where permitted by state or provincial law, we may sell a life insurance or annuity policy from third-party insurance companies, for which we earn a commission as general sales agent for the insurance company. These general agency commissions (GA revenue) are based on a percentage per contract sold and are recognized as funeral revenue when the insurance purchase transaction between the preneed purchaser and third-party insurance provider is completed. All selling costs incurred pursuant to the sale of insurance-funded preneed contracts are expensed as incurred. We do not reflect the unfulfilled insurance-funded preneed contract amounts in our Condensed Consolidated Balance Sheet. The policyholder has made a revocable commitment to assign the proceeds from the policy to us at the time of need. The proceeds of the life insurance policies or annuity contracts will be reflected in funeral revenue as we perform these funerals.

#### **Cash, Cash Equivalents, and Restricted Cash**

The components of cash, cash equivalents, and restricted cash at September 30, 2018 and December 31, 2017 are as follows:

	September 30, 2018	December 31, 2017
	(In thousands)	
Cash and cash equivalents	\$ 158,301	\$ 330,039
Restricted cash <sup>(1)</sup> :		
Included in <i>Other current assets</i>	5,692	8,625
Included in <i>Deferred charges and other assets</i>	1,945	1,937
Total restricted cash	7,637	10,562
Total cash, cash equivalents, and restricted cash	\$ 165,938	\$ 340,601

<sup>(1)</sup> Restricted cash in both periods primarily consists of proceeds from divestitures deposited into escrow accounts under IRS code section 1031 and collateralized obligations under certain insurance policies.

#### **Accounting Standards Adopted in 2018**

##### *Revenue Recognition*

In May 2014, the FASB issued "Revenue from Contracts with Customers," which replaced existing revenue recognition guidance. During 2016, the FASB made several amendments to the new standard that clarified guidance on several matters, including principal vs. agent considerations, identifying performance obligations, sales taxes, and licensing.

The new standard, as amended, requires that we recognize revenue in the amount of which we expect to be entitled for delivery of promised goods and services to our customers. The new standard also resulted in enhanced revenue-related disclosures, including any significant judgments and changes in judgments. Additionally, the new standard requires the deferral of incremental direct selling costs to the period in which the related revenue is recognized.

The standard primarily impacts the manner in which we recognize a) certain nonrefundable up-front fees and b) incremental costs to acquire new preneed funeral trust contracts and preneed and atneed cemetery contracts (i.e., selling costs). The nonrefundable fees will be deferred and recognized as revenue when the underlying goods and services are delivered to the customer. The incremental direct selling costs will be deferred and recognized by specific identification to the delivery of the underlying goods and services.

We adopted the standard as of January 1, 2018 using the modified retrospective approach applied to all contracts that were not completed at adoption based on the contract terms in existence at adoption. As a result of the adoption, we recorded a \$172.2 million increase to *Retained earnings*, which comprises a \$268.0 million increase to *Deferred charges and other assets* partially offset by a \$38.0 million increase to *Deferred revenue, net* and a \$57.8 million increase to *Deferred tax liability*. We made the enhanced revenue-related disclosures in Footnotes 2, 3, and 8 of this Form 10-Q.

Additionally, the amounts due from customers for unfulfilled performance obligations on cancelable preneed contracts are required to be presented with *Deferred revenue, net*, instead of as *Preneed receivables, net and trust investments* on our unaudited Condensed Consolidated Balance Sheet. Accordingly, we reclassified \$544.8 million of these amounts from *Preneed receivables, net and trust investments* to *Deferred revenue, net*. As a result of this reclassification, we eliminated our previous cancellation reserve on these performance obligations.

We will continue to expense costs to acquire new preneed funeral insurance contracts in the period incurred. The insurance contracts are not, and will not be, reflected in our unaudited Condensed Consolidated Balance Sheet because they do not

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represent assets or liabilities, as we have no claim to the insurance proceeds until the contract is fulfilled and no obligation under the contract until the benefits are assigned to us at the time of need.

The impact of adopting the new guidance on our unaudited Condensed Consolidated Statement of Operations for the three and nine months ended September 30, 2018 are as follows:

	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	As Reported	Effect of New Guidance	Without New Guidance	As Reported	Effect of New Guidance	Without New Guidance
	(in thousands, except per share amounts)					
Revenue	\$ 778,786	\$ 106	\$ 778,892	\$ 2,369,360	\$ 1,124	\$ 2,370,484
Costs and expenses	(612,616)	(253)	(612,869)	(1,819,301)	(14,205)	(1,833,506)
Operating profit (loss)	166,170	(147)	166,023	550,059	(13,081)	536,978
General and administrative expenses	(41,070)	—	(41,070)	(106,990)	—	(106,990)
Gain on divestitures and impairment charges, net	7,970	—	7,970	15,317	—	15,317
Hurricane recoveries, net	(767)	—	(767)	(437)	—	(437)
Operating income (loss)	132,303	(147)	132,156	457,949	(13,081)	444,868
Interest expense	(46,419)	—	(46,419)	(134,514)	—	(134,514)
Loss on early extinguishment of debt, net	—	—	—	(10,131)	—	(10,131)
Other income, net	152	—	152	2,416	—	2,416
Income (loss) before income taxes	86,036	(147)	85,889	315,720	(13,081)	302,639
(Provision for) benefit from income taxes	(17,043)	42	(17,001)	(61,398)	2,538	(58,860)
Net income (loss)	68,993	(105)	68,888	254,322	(10,543)	243,779
Net income attributable to noncontrolling interests	(58)	—	(58)	(160)	—	(160)
Net income (loss) attributable to common stockholders	\$ 68,935	\$ (105)	\$ 68,830	\$ 254,162	\$ (10,543)	\$ 243,619
Earnings per share <sup>(1)</sup>						
Basic	\$ 0.38	\$ —	\$ 0.38	\$ 1.39	\$ (0.06)	\$ 1.33
Diluted	\$ 0.37	\$ —	\$ 0.37	\$ 1.36	\$ (0.06)	\$ 1.30

<sup>(1)</sup> Net income per share is computed independently for each of the columns presented. Therefore, the sum of the first two columns' earnings per share may not equal the Without New Guidance column.

*Cash Flow*

In August and November 2016, the FASB amended "Statement of Cash Flows" to clarify guidance on the classification of certain cash receipts and cash payments. Additionally, the guidance requires that the statement of cash flows reflects changes in restricted cash in addition to cash and cash equivalents. Amended guidance includes clarification on debt prepayments and extinguishment costs, contingent consideration in business combinations, proceeds from insurance claims, and premium payments on Company-owned life insurance. We adopted the new guidance retrospectively on January 1, 2018. As a result, we have recast our unaudited Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2017 as follows:

	As Previously Reported	Effect of New Guidance	As Recast
	(in thousands)		
Net cash provided by (used in) operating activities	\$ 389,614	\$ (131)	\$ 389,483
<b>Cash flows from investing activities:</b>			
Capital expenditures	(141,652)	—	(141,652)
Acquisitions, net of cash acquired	(49,635)	(26,183)	(75,818)
Proceeds from divestitures and sales of property and equipment	12,547	20,041	32,588
Payments for Company-owned life insurance policies	—	(6,189)	(6,189)
Proceeds from Company-owned life insurance policies	—	2,591	2,591
Other	175	—	175
Net cash used in investing activities	(178,565)	(9,740)	(188,305)
Net cash used in financing activities	(147,532)	—	(147,532)
Effect of foreign currency on cash, cash equivalents, and restricted cash	9,453	10	9,463
Net increase in cash, cash equivalents, and restricted cash	72,970	(9,861)	63,109
Cash, cash equivalents, and restricted cash at beginning of period	194,986	16,520	211,506
Cash, cash equivalents, and restricted cash at end of period	\$ 267,956	\$ 6,659	\$ 274,615

#### *Retirement Plans*

In March 2017, the FASB amended "*Retirement Plans*" to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost by requiring the classification of interest costs and actuarial gains and losses separately from operating income on the unaudited Condensed Consolidated Statement of Operations. We adopted the new guidance on January 1, 2018 and applied the practical expedient of reclassifying the amounts disclosed as "total net periodic benefit cost" in Note 11 to our December 31, 2017 Form 10-K from *Operating income* to *Other income (expense), net*. For the third quarter of 2017, we reclassified \$74 thousand and \$221 thousand from *Costs and expenses* and *General and administrative expenses*, respectively, to *Other income (expense), net*. For the first nine months of 2017 we reclassified \$221 thousand and \$663 thousand from *Costs and expenses* and *General and administrative expenses*, respectively, to *Other income (expense), net*.

#### *Financial Instruments*

In January 2016 and February 2018, the FASB amended "*Financial Instruments*" to provide additional guidance on the recognition and measurement of financial assets and liabilities. The amendment requires investments in equity instruments to be measured at fair value with changes in fair value reflected in net income. For us, these changes in fair value will be offset by a corresponding change in the fair value of *Deferred receipts held in trust* or *Care trusts' corpus*. The amendment also changes the required disclosures associated with equity instruments as a result of the change in presentation. The new guidance was effective for us on January 1, 2018 and our adoption did not materially impact our consolidated results of operations, consolidated financial position, and cash flows as of and for the three and nine months ended September 30, 2018. We made the appropriate disclosure changes in Footnote 3 of this Form 10-Q.

#### *Stock Compensation*

In May 2017, the FASB amended "*Stock Compensation*" to clarify which changes in terms and conditions of share-based awards require accounting for as modifications. Under the new guidance, modification accounting is required only if the fair value, vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. We adopted the new guidance on January 1, 2018, which did not have an impact on our consolidated results of operations, consolidated financial position, and cash flows.

#### **Recently Issued Accounting Standards**

##### *Financial Instruments*

In June 2016, the FASB amended "*Financial Instruments*" to provide financial statement users with more decision-useful information about the expected credit losses on debt instruments and other commitments to extend credit held by a reporting entity at each reporting date. This amendment replaces the incurred loss impairment methodology in the current standard with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to support credit loss estimates. The new guidance is effective for us on January 1, 2020, and we are still evaluating the impact of adoption on our consolidated results of operations, consolidated financial position, and cash flows.

##### *Leases*

In February 2016, January 2018, and July 2018, the FASB amended "*Leases*" to increase transparency and comparability among organizations. Under the new standard, an entity will be required to recognize right of use lease assets and liabilities on its balance sheet and disclose key information about leasing arrangements. In addition, the new standard offers specific accounting guidance for a lessee, a lessor, and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.

We will adopt ASU 2016-02 "Leases" on January 1, 2019 using the modified retrospective transition method, with a cumulative effect adjustment to opening *Retained earnings* recorded as of that date. The modified retrospective transition method includes a number of optional practical expedients and accounting policy elections.

- 1) We will elect a Package of Practical Expedients to not reassess:
  - whether a contract is or contains a lease (as an accounting policy election, we will not reassess whether arrangements grandfathered under EITF 01-8 are or contain leases),
  - lease classification, or
  - initial direct costs.
- 2) We will not elect a practical expedient to use hindsight when determining lease term.
- 3) We will elect the short-term lease recognition exemption.
- 4) The remaining practical expedients do not apply or are not expected to have a material impact.

We have established a team to implement the standard update. The implementation team reports findings and progress of the project to management on a frequent basis. We have begun implementation of a new enterprise-wide lease management system in the form of a pre-configured software as a service cloud-based application to support the adoption and ongoing lease

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requirements under the new guidance. This system serves as a lease database to manage our lease inventory centrally and ensure completeness of lease inventory. The system also produces accounting entries and financial reporting disclosures accurately under the new guidance and provides lease activity business intelligence reporting. We are currently testing the new system to ensure it produces the data to prepare the required accounting entries and disclosures under the new guidance upon adoption and on an ongoing basis. We are evaluating additional changes to our processes and internal controls to facilitate adoption on January 1, 2019 and to meet the standard's on-going reporting and disclosure requirements.

Our current operating lease portfolio is primarily composed of real estate and equipment. Upon adoption of this standard, we expect to recognize a right-of-use asset and liability related to substantially all operating lease arrangements. We are developing our estimate of the right-of-use asset and lease liability based on the present value of the lease payments. Based on our current lease portfolio, we expect the adoption of the new standard to significantly impact our consolidated financial position due to the recognition of the right-of-use asset and liability for our operating leases. However, the ultimate impact of adoption will depend on the lease portfolio as of the adoption date.

### *Goodwill*

In January 2017, the FASB amended "*Goodwill*" to simplify the subsequent measurement of goodwill. The amended guidance eliminates Step 2 from the goodwill impairment test. Instead, impairment is defined as the amount by which the carrying value of the reporting unit exceeds its fair value, up to the total amount of goodwill. The new guidance is effective for us on January 1, 2020, and is not expected to have an impact on our consolidated results of operations, consolidated financial position, and cash flows.

### *Fair Value Measurements*

In August 2018, the FASB amended "*Fair Value Measurements*" to modify the disclosure requirements. The amendment removes requirements to disclose (1) the amount of and reasons for transfers between levels 1 and 2 of the fair value hierarchy, (2) our policy for timing of transfers between levels, and (3) the valuation processes used in level 3 measurements. It clarifies that, for investments measured at net asset value, disclosure of liquidation timing is only required if the investee has communicated the timing either to us or publicly. It also clarifies that the narrative disclosure of the effect of changes in level 3 inputs should be based on changes that could occur at the reporting date. The amendment adds a requirement to disclose the range and weighted average of significant unobservable inputs used in level 3 measurements. The guidance is effective for us with our quarterly filing for the period ended March 31, 2020 and is not expected to have an impact on our consolidated results of operations, consolidated financial position, and cash flows.

### *Retirement Plans*

In August 2018, the FASB amended "*Retirement Plans*" to modify the disclosure requirements for defined benefit plans. For us, the amendment requires the disclosure of the weighted average interest crediting rate used for cash balance plans and an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. It removes the requirement to disclose the approximate amount of future benefits covered by insurance contracts. The guidance is effective for us with our annual filing for the year ended December 31, 2020 and is not expected to have an impact on our consolidated results of operations, consolidated financial position, and cash flows.

### *Internal Use Software*

In August 2018, the FASB amended "*Internal Use Software*" to align the requirements for capitalizing implementation costs incurred in a hosting arrangement for software-as-a-service that is a service contract with the requirements for capitalizing those costs in a hosting arrangement that includes a software license. Costs for implementation activities in the application development stage are capitalized, depending on the nature of the costs, while costs incurred during the preliminary project and postimplementation stages are expensed. Any capitalized costs are expensed over the term of the hosting arrangement. Cash payments for the implementation costs, whether capitalized or not, are presented as operating outflows as that is consistent with the presentation of the fees in the hosting arrangement. The new guidance is effective for us on January 1, 2020, and we are still assessing the impact on our consolidated results of operations, consolidated financial position, and cash flows.



### 3. Preneed Activities

#### *Preneed receivables, net and trust investments*

The components of *Preneed receivables, net and trust investments* in our unaudited Condensed Consolidated Balance Sheet at September 30, 2018 and December 31, 2017 are as follows:

	September 30, 2018	December 31, 2017
	(In thousands)	
Preneed funeral receivables <sup>(1)</sup>	\$ 117,730	\$ 336,925
Preneed cemetery receivables <sup>(1)</sup>	856,637	1,118,146
Preneed receivables from customers <sup>(1)</sup>	974,367	1,455,071
Unearned finance charge	(46,273)	(45,515)
Allowance for cancellation <sup>(1)</sup>	(48,667)	(107,749)
Preneed receivables, net	\$ 879,427	\$ 1,301,807
Trust investments, at market	\$ 5,023,407	\$ 4,749,548
Insurance-backed fixed income securities and other	262,178	259,654
Trust investments	5,285,585	5,009,202
Less: Cemetery perpetual care trust investments	(1,596,542)	(1,532,167)
Preneed trust investments	\$ 3,689,043	\$ 3,477,035
Preneed receivables, net and trust investments	\$ 4,568,470	\$ 4,778,842

- (1) Upon adoption of "Revenue from Contracts with Customers" on January 1, 2018, we reclassified amounts due from customers for unfulfilled performance obligations on cancelable preneed contracts as a reduction in *Deferred revenue, net*. As a result of this reclassification, we eliminated the allowance for cancellation on these performance obligations.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
	(In thousands)			
Deposits	\$ 96,539	\$ 86,028	\$ 296,651	\$ 277,286
Withdrawals	\$ 97,525	\$ 99,872	\$ 318,818	\$ 297,595
Purchases of securities	\$ 265,125	\$ 886,732	\$ 1,273,683	\$ 1,792,190
Sales of securities	\$ 295,983	\$ 509,675	\$ 1,331,981	\$ 1,742,860
Realized gains <sup>(1)</sup>	\$ 70,095	\$ 79,971	\$ 216,241	\$ 185,897
Realized losses <sup>(1)</sup>	\$ (20,358)	\$ (17,707)	\$ (50,210)	\$ (62,657)

- (1) All realized gains and losses are recognized in *Other income (expense), net* for our trust investments and are offset by a corresponding reclassification in *Other income (expense), net to Deferred receipts held in trust and Care trusts' corpus*.

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The costs and values associated with trust investments recorded at fair value at September 30, 2018 and December 31, 2017 are detailed below. Cost reflects the investment (net of redemptions) of control holders in the trusts. Fair value represents the value of the underlying securities held by the trusts.

September 30, 2018					
Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Value	
(In thousands)					
<b>Fixed income securities:</b>					
U.S. Treasury	2	\$ 49,924	\$ 14	\$ (621)	\$ 49,317
Canadian government	2	59,507	36	(1,738)	57,805
Corporate	2	24,962	67	(336)	24,693
Residential mortgage-backed	2	3,809	10	(91)	3,728
Asset-backed	2	142	2	(10)	134
<b>Equity securities:</b>					
Preferred stock	2	10,080	891	(186)	10,785
<b>Common stock:</b>					
United States	1	1,208,054	295,891	(42,913)	1,461,032
Canada	1	36,162	11,804	(1,425)	46,541
Other international	1	75,039	10,707	(4,613)	81,133
<b>Mutual funds:</b>					
Equity	1	728,307	45,012	(12,089)	761,230
Fixed income	1	1,231,818	3,492	(46,257)	1,189,053
Other	3	14,726	4,228	—	18,954
Trust investments, at fair value		<u>3,442,530</u>	<u>372,154</u>	<u>(110,279)</u>	<u>3,704,405</u>
<b>Commingled funds</b>					
Fixed income		427,226	2,462	(17,359)	412,329
Equity		206,040	40,558	(2)	246,596
Money market funds		380,743	—	—	380,743
Private equity		212,462	68,388	(1,516)	279,334
Trust investments, at net asset value		<u>1,226,471</u>	<u>111,408</u>	<u>(18,877)</u>	<u>1,319,002</u>
Trust investments, at market		<u>\$ 4,669,001</u>	<u>\$ 483,562</u>	<u>\$ (129,156)</u>	<u>\$ 5,023,407</u>

December 31, 2017						
Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Value		
(In thousands)						
<b>Fixed income securities:</b>						
U.S. Treasury	2	\$ 48,805	\$ 14	\$ (117)	\$ 48,702	
Canadian government	2	81,500	160	(1,089)	80,571	
Corporate	2	13,540	327	(170)	13,697	
Residential mortgage-backed	2	3,279	16	(14)	3,281	
Asset-backed	2	320	15	(10)	325	
<b>Equity securities:</b>						
Preferred stock	2	7,834	385	(139)	8,080	
<b>Common stock:</b>						
United States	1	1,161,015	266,822	(24,739)	1,403,098	
Canada	1	30,762	12,545	(522)	42,785	
Other international	1	63,510	13,174	(2,834)	73,850	
<b>Mutual funds:</b>						
Equity	1	613,934	59,100	(4,312)	668,722	
Fixed income	1	1,230,196	11,897	(23,943)	1,218,150	
Other	3	5,953	3,114	—	9,067	
<b>Trust investments, at fair value</b>						
Commingled funds						
Fixed income		454,242	235	(5,860)	448,617	
Equity		214,000	12,826	—	226,826	
Money market funds		287,435	—	—	287,435	
Private equity		166,860	51,631	(2,149)	216,342	
Trust investments, at net asset value		1,122,537	64,692	(8,009)	1,179,220	
Trust investments, at market		\$ 4,383,185	\$ 432,261	\$ (65,898)	\$ 4,749,548	

As of September 30, 2018, our unfunded commitment for our private equity and other investments was \$96.3 million which, if called, would be funded by the assets of the trusts.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
(In thousands)				
Fair value, beginning balance	\$ 20,194	\$ 7,924	\$ 9,067	\$ 7,163
Net unrealized gains (losses) included in <i>Other income (expense), net</i> <sup>(1)</sup>	1,020	(116)	750	694
Purchases	36	1,881	43	1,909
Sales	(9)	(854)	(9)	(931)
Acquisitions	(2,287)	—	9,103	—
Fair value, ending balance	\$ 18,954	\$ 8,835	\$ 18,954	\$ 8,835

(1) All net unrealized gains (losses) recognized in *Other income (expense), net* for our trust investments are offset by a corresponding reclassification in *Other income (expense), net* to *Deferred receipts held in trust* and *Care trusts' corpus*.

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Maturity dates of our fixed income securities range from 2018 to 2077. Maturities of fixed income securities (excluding mutual funds) at September 30, 2018 are estimated as follows:

	Fair Value (In thousands)
Due in one year or less	\$ 64,152
Due in one to five years	59,940
Due in five to ten years	10,290
Thereafter	1,295
	<u>\$ 135,677</u>

Recognized trust fund income (realized and unrealized) related to these trust investments was \$50.2 million and \$39.1 million for the three months ended September 30, 2018 and 2017, respectively. Recognized trust fund income (realized and unrealized) related to these trust investments was \$147.3 million and \$122.6 million for the nine months ended September 30, 2018 and 2017, respectively.

We have determined that the unrealized losses in our fixed income investments are considered temporary in nature, as the unrealized losses were due to temporary fluctuations in interest rates. We believe that none of the securities are other-than-temporarily impaired based on our analysis of the investments. Our analysis included a review of the portfolio holdings and discussions with the individual money managers as to the credit ratings and the severity and duration of the unrealized losses. Our fixed income investment unrealized losses, their associated values, and the duration of unrealized losses as of September 30, 2018 and December 31, 2017, respectively, are shown in the following tables:

	September 30, 2018					
	In Loss Position Less Than 12 Months		In Loss Position Greater Than 12 Months		Total	
	Value	Unrealized Losses	Value	Unrealized Losses	Value	Unrealized Losses
	(In thousands)					
Fixed income securities:						
U.S. Treasury	\$ 25,192	\$ (576)	\$ 3,119	\$ (45)	\$ 28,311	\$ (621)
Canadian government	—	—	26,469	(1,738)	26,469	(1,738)
Corporate	9,332	(65)	6,089	(271)	15,421	(336)
Residential mortgage-backed	3,378	(89)	100	(2)	3,478	(91)
Asset-backed	—	—	99	(10)	99	(10)
Total temporarily fixed income impaired securities	<u>\$ 37,902</u>	<u>\$ (730)</u>	<u>\$ 35,876</u>	<u>\$ (2,066)</u>	<u>\$ 73,778</u>	<u>\$ (2,796)</u>

	December 31, 2017					
	In Loss Position Less Than 12 Months		In Loss Position Greater Than 12 Months		Total	
	Value	Unrealized Losses	Value	Unrealized Losses	Value	Unrealized Losses
	(In thousands)					
Fixed income securities:						
U.S. Treasury	\$ 29,014	\$ (115)	\$ 106	\$ (2)	\$ 29,120	\$ (117)
Canadian government	20,947	(639)	6,370	(450)	27,317	(1,089)
Corporate	2,423	(31)	4,453	(139)	6,876	(170)
Residential mortgage-backed	2,880	(12)	151	(2)	3,031	(14)
Asset-backed	—	—	74	(10)	74	(10)
Total temporarily impaired fixed income securities	<u>\$ 55,264</u>	<u>\$ (797)</u>	<u>\$ 11,154</u>	<u>\$ (603)</u>	<u>\$ 66,418</u>	<u>\$ (1,400)</u>

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**Deferred revenue, net**

The components of *Deferred revenue, net* in our unaudited Condensed Consolidated Balance Sheet at September 30, 2018 and December 31, 2017 are as follows:

	September 30, 2018	December 31, 2017
	(In thousands)	
Deferred revenue	\$ 1,999,092	\$ 1,789,776
Amounts due from customers for unfulfilled performance obligations on cancelable preneed contracts <sup>(1)</sup>	(567,911)	—
<b>Deferred revenue, net</b>	<b>\$ 1,431,181</b>	<b>\$ 1,789,776</b>

(1) Prior to adoption of "Revenue from Contracts with Customers" on January 1, 2018, amounts due from customers for unfulfilled performance obligations on cancelable preneed contracts were included in *Preneed receivables, net and trust investments*.

The following table summarizes the activity in our contract liabilities, which are recorded in *Deferred revenue, net* and *Deferred receipts held in trust* for the nine months ended September 30, 2018:

	2018
	(In thousands)
Beginning balance — <i>Deferred revenue, net</i> and <i>Deferred receipts held in trust</i>	\$ 5,265,206
Cumulative effect of accounting changes	37,991
Net preneed contract sales	745,566
Acquisitions (divestitures) of businesses, net	159,194
Net investment earnings <sup>(1)</sup>	102,119
Recognized revenue from backlog <sup>(2)</sup>	(297,407)
Recognized revenue from current period sales	(403,477)
Change in amounts due on unfulfilled performance obligations	(544,780)
Change in cancellation reserve	62,120
Effect of foreign currency and other	(7,957)
<b>Ending balance — <i>Deferred revenue, net</i> and <i>Deferred receipts held in trust</i></b>	<b>\$ 5,118,575</b>

(1) Includes both realized and unrealized investment earnings.

(2) Includes current year trust fund income through the date of performance.

**4. Income Taxes**

On December 22, 2017, the U.S. federal government enacted the Tax Cuts and Jobs Act (the Tax Act), which significantly revised U.S. corporate income tax law by, among other things, reducing the U.S. federal corporate income tax rate from 35% to 21% and implementing a modified territorial tax system that includes a one-time transition tax on deemed repatriated earnings of foreign subsidiaries. Due to the complexities involved in accounting for the Tax Act, the SEC issued Staff Accounting Bulletin (SAB) 118, which requires that we include in our financial statements the reasonable estimate of the impact of the Tax Act on earnings to the extent such reasonable estimate has been determined.

SAB 118 allows us to report provisional amounts within a measurement period up to one year due to the complexities inherent in adopting the changes. We consider both the recognition of the transition tax and the remeasurement of deferred taxes incomplete. We adjusted our provisional amounts during the nine months ended September 30, 2018 by \$16.3 million due to the remeasurement of deferred taxes resulting from a change in estimate related to the finalization of the 2017 tax return. Additionally, new guidance from regulators, interpretation of the law, and refinement of our estimates from ongoing analysis of data and tax positions may change the provisional amounts recorded. Any changes in the provisional amount recorded will be reflected in income tax expense in the period identified.

Income tax expense during interim periods is based on our estimated annual effective income tax rate plus any discrete items, which are recorded in the period in which they occur. Discrete items include, among others, such events as changes in estimates due to the finalization of tax returns, tax audit settlements, expiration of statutes of limitation, and increases or decreases in valuation allowances on deferred tax assets. Our effective tax rate was 19.8% and 15.7% for the three months ended September 30, 2018 and 2017, respectively. The increase in the effective tax rate for the three months ended September 30, 2018 was primarily the result of lower tax benefits recognized on the settlement of employee share-based awards. Our effective tax rate was an expense of 19.4% and a benefit of 12.3% for the nine months ended September 30, 2018 and 2017,

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respectively. The higher effective tax rate for the nine months ended September 30, 2018 was primarily due to the effects of the 2017 IRS audit settlement, partially offset by the decrease in the U.S. federal income tax rate and remeasurement of deferred taxes as a result of the change in estimate in the finalization of the 2017 tax return.

#### *Unrecognized Tax Benefits*

As of September 30, 2018, the total amount of our unrecognized tax benefits was \$80.8 million and the year-to-date total amount of our accrued interest was \$13.2 million.

In March 2017, we received from the IRS Office of Appeals the fully executed Form 870-AD for the years 1999-2005, which effectively settled the issues under audit for those years. Tax years subsequent to 2005 remain open to review and adjustment by the IRS. In addition, we are under audit by various state jurisdictions for years 2009 through 2017. There are currently no federal or provincial audits in Canada. It is reasonably possible that the amount of unrecognized tax benefits could significantly decrease over the next 12 months as certain tax positions will be released as a result of statutes closing. However, since the years to which uncertain tax positions relate remain subject to review by the tax authorities, a current estimate of the range of decrease that may occur within the next 12 months cannot be made.

#### **5. Debt**

Debt as of September 30, 2018 and December 31, 2017 was as follows:

	September 30, 2018	December 31, 2017
	(In thousands)	
7.625% Senior Notes due October 2018	\$ —	\$ 250,000
4.5% Senior Notes due November 2020	200,000	200,000
8.0% Senior Notes due November 2021	150,000	150,000
5.375% Senior Notes due January 2022	425,000	425,000
5.375% Senior Notes due May 2024	850,000	850,000
7.5% Senior Notes due April 2027	200,000	200,000
4.625% Senior Notes due December 2027	550,000	550,000
Term Loan due December 2022	649,688	675,000
Bank Credit Facility due December 2022	395,000	—
Obligations under capital leases	212,126	197,232
Mortgage notes and other debt, maturities through 2050	5,749	6,036
Unamortized premiums, net	6,789	7,456
Unamortized debt issuance costs	(33,232)	(38,071)
Total debt	3,611,120	3,472,653
Less: Current maturities of long-term debt	(68,806)	(337,337)
Total long-term debt	\$ 3,542,314	\$ 3,135,316

Current maturities of debt at September 30, 2018 include amounts due under our Term Loan, mortgage notes and other debt, and capital leases within the next year.

Our consolidated debt had a weighted average interest rate of 4.93% and 4.73% at September 30, 2018 and December 31, 2017, respectively. Approximately 66% and 75% of our total debt had a fixed interest rate at September 30, 2018 and December 31, 2017, respectively.

During the nine months ended September 30, 2018 and 2017, we paid \$113.1 million and \$101.7 million in cash interest, respectively.

#### **Bank Credit Agreement**

As of September 30, 2018, we have \$395.0 million of outstanding borrowings under our Bank Credit Facility due December 2022; \$649.7 million of outstanding borrowings under our Term Loan due December 2022; and issued \$33.3 million of letters of credit. The bank credit agreement provides us with flexibility for working capital, if needed, and is guaranteed by a majority of our domestic subsidiaries. The subsidiary guaranty is a guaranty of payment of the outstanding amount of the total lending commitment, including letters of credit. The bank credit agreement contains certain financial covenants, including a minimum interest coverage ratio, a maximum leverage ratio, and certain dividend and share repurchase restrictions. As of September 30, 2018, we were in compliance with all of our debt covenants. We pay a quarterly fee on the unused commitment, which was 0.25% at September 30, 2018. As of September 30, 2018, we have \$571.7 million in borrowing capacity under the Bank Credit Facility.

**Debt Issuances and Additions**

During the nine months ended September 30, 2018, we drew \$395.0 million on our Bank Credit Facility as follows:

- \$175.0 million to fund the redemption of our 7.625% Senior notes due October 2018 in January 2018.
- \$10.0 million to make required payments on our Term Loan due December 2022 in March 2018.
- \$185.0 million to fund acquisition activity, to make required payments on our Term Loan due December 2027 and for general corporate purposes in June 2018.
- \$25.0 million to fund acquisition activity and for general corporate purposes in September 2018.

During the nine months ended September 30, 2017, we drew \$120.0 million on our Bank Credit Facility to make required payments on our Term Loan, to fund our IRS settlement payments, and for general corporate purposes.

**Debt Extinguishments and Reductions**

During the nine months ended September 30, 2018, we made aggregate debt payments of \$285.2 million for scheduled and early extinguishment payments including:

- \$250.0 million in aggregate principal of our 7.625% Senior Notes due October 2018;
- \$9.6 million in call premium for redemption of the 7.625% Senior Notes due October 2018;
- \$25.3 million in aggregate principal of our Term Loan due December 2022; and
- \$0.3 million in other debt.

Certain of the above transactions resulted in the recognition of a loss of \$10.1 million recorded in *Loss on early extinguishment of debt* in our unaudited Condensed Consolidated Statement of Operations for the nine months ended September 30, 2018.

During the nine months ended September 30, 2017, we made aggregate principal debt payments of \$26.4 million, including \$26.3 million for scheduled payments towards our Term Loan.

**6. Fair Value of Financial Instruments**

**Fair Value Estimates**

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

The fair value of our debt instruments at September 30, 2018 and December 31, 2017 was as follows:

	September 30, 2018	December 31, 2017
	(In thousands)	
7.625% Senior Notes due October 2018	\$ —	\$ 259,563
4.5% Senior Notes due November 2020	200,000	199,590
8.0% Senior Notes due November 2021	166,200	175,313
5.375% Senior Notes due January 2022	430,911	436,178
5.375% Senior Notes due May 2024	867,000	892,118
7.5% Senior Notes due April 2027	225,500	238,004
4.625% Senior Notes due December 2027	528,000	558,250
Term Loan due December 2022	649,688	675,000
Bank Credit Facility due December 2022	395,000	—
Mortgage notes and other debt, maturities through 2050	5,749	6,036
<b>Total fair value of debt instruments</b>	<b>\$ 3,468,048</b>	<b>\$ 3,440,052</b>

The fair value of our long-term, fixed-rate loans were estimated using market prices for those loans, and therefore are classified within Level 2 of the fair value measurements hierarchy. The Term Loan, Bank Credit Facility agreement, and the mortgage notes and other debt are classified within Level 3 of the fair value measurements hierarchy. The fair value of these instruments was estimated using a discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements. An increase (decrease) in the inputs results in a directionally opposite change in the fair value of the instruments.

## 7. Equity

### Share Repurchases

Subject to market conditions, normal trading restrictions, and limitations in our debt covenants, we may make purchases in the open market or through privately negotiated transactions under our stock repurchase program. During the nine months ended September 30, 2018, we repurchased 7,301,736 shares of common stock at an aggregate cost of \$275.7 million, which is an average cost per share of \$37.76. After these repurchases, the remaining dollar value of shares authorized to be purchased under our share repurchase program was approximately \$194.4 million at September 30, 2018.

### 8. Segment Reporting

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

Our reportable segment, including disaggregated revenue, information is as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017 <sup>(1)</sup>	2018	2017 <sup>(1)</sup>
(In thousands)				
<b>Revenue from customers:</b>				
Funeral revenue:				
Atneed revenue	\$ 236,021	\$ 236,166	\$ 753,378	\$ 757,096
Matured preneed revenue	138,754	135,219	450,081	425,281
Core funeral revenue	374,775	371,385	1,203,459	1,182,377
Non-funeral home revenue	11,534	10,783	37,249	34,804
Recognized preneed revenue	32,129	26,630	98,508	88,883
Other revenue	32,518	28,731	94,753	89,103
Total funeral revenue	450,956	437,529	1,433,969	1,395,167
Cemetery revenue:				
Atneed revenue	76,983	76,079	240,967	238,196
Recognized preneed property revenue	151,269	129,611	403,375	378,546
Recognized preneed merchandise and services revenue	68,967	69,255	210,460	206,376
Core cemetery revenue	297,219	274,945	854,802	823,118
Other revenue	30,611	18,872	80,589	64,013
Total cemetery revenue	327,830	293,817	935,391	887,131
Total revenue from customers	\$ 778,786	\$ 731,346	\$ 2,369,360	\$ 2,282,298
<b>Operating profit:</b>				
Funeral operating profit	\$ 68,145	\$ 70,118	\$ 279,021	\$ 274,802
Cemetery operating profit	98,025	79,658	271,038	235,731
Operating profit from reportable segments	166,170	149,776	550,059	510,533
General and administrative expenses	(41,070)	(38,992)	(106,990)	(121,644)
Gains (losses) on divestitures and impairment charges, net	7,970	(143)	15,317	5,545
Hurricane expenses, net	(767)	(1,290)	(437)	(1,290)
Operating income	132,303	109,351	457,949	393,144
Interest expense	(46,419)	(42,754)	(134,514)	(125,473)
Loss on early extinguishment of debt, net	—	—	(10,131)	—
Other income (expense), net	152	(19)	2,416	(1,049)
Income before income taxes	\$ 86,036	\$ 66,578	\$ 315,720	\$ 266,622

<sup>(1)</sup> The results for the three and nine months ended September 30, 2017 have not been adjusted for the impact of our adoption of "Revenue from Contracts with Customers" on January 1, 2018.



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Our geographic area information is as follows:

	United States	Canada	Total
	(In thousands)		
<b>Three Months Ended September 30,</b>			
Revenue from external customers:			
2018	\$ 731,147	\$ 47,639	\$ 778,786
2017 <sup>(1)</sup>	\$ 685,186	\$ 46,160	\$ 731,346
<b>Nine Months Ended September 30,</b>			
Revenue from external customers:			
2018	\$ 2,225,705	\$ 143,655	\$ 2,369,360
2017 <sup>(1)</sup>	\$ 2,140,796	\$ 141,502	\$ 2,282,298

<sup>(1)</sup> The results for the three and nine months ended September 30, 2017 have not been adjusted for the impact of our adoption of "Revenue from Contracts with Customers" on January 1, 2018.

## 9. Commitments and Contingencies

### Insurance Loss Reserves

We purchase comprehensive general liability, morticians' and cemetery professional liability, automobile liability, and workers' compensation insurance coverage, all of which are structured with high deductibles. The high-deductible insurance program means we are primarily self-insured for claims and associated costs and losses covered by these policies. As of September 30, 2018 and December 31, 2017, we have self-insurance reserves of \$76.6 million and \$78.2 million, respectively.

### Litigation and Regulatory Matters

We are a party to various litigation and regulatory matters, investigations, and proceedings. Some of the more frequent routine litigations incidental to our business are based on burial practices claims and employment-related matters, including discrimination, harassment, and wage and hour laws and regulations. For each of our outstanding legal matters, we evaluate the merits of the case, our exposure to the matter, possible legal or settlement strategies, and the likelihood of an unfavorable outcome. We intend to vigorously defend ourselves in the matters described herein; however, if we determine that an unfavorable outcome is probable and can be reasonably estimated, we establish the necessary accruals. We hold certain insurance policies that may reduce cash outflows with respect to an adverse outcome of certain of these matters. We accrue such insurance recoveries when they become probable of being paid and can be reasonably estimated.

**Wage and Hour Claims.** We are named a defendant in various lawsuits alleging violations of federal and state laws regulating wage and hour pay, including but not limited to the Samborsky, Vasquez, Fredeen, Romano, Doyle, Horton, Quismundo, and Kallweit lawsuits described below. Given the nature of these lawsuits, we are unable to reasonably estimate the possible loss or ranges of loss, if any.

*Charles Samborsky, et al, individually and on behalf of those persons similarly situated, v. SCI California Funeral Services, Inc., et al*; Case No. BC544180; in the Superior Court of the State of California for the County of Los Angeles, Central District-Central Civil West Courthouse. This lawsuit was filed in April 2014 against an SCI subsidiary and purports to have been brought on behalf of employees who worked as family service counselors in California since April 2010. The plaintiffs allege causes of action for various violations of state laws regulating wage and hour pay. In addition, this lawsuit also asserts claims under the California Private Attorney General Act (PAGA) provisions on behalf of other similarly situated California persons. The plaintiffs seek unpaid wages, compensatory and punitive damages, attorneys' fees and costs, interest, and injunctive relief. The claims have been sent to arbitration. In July 2017, the arbitrator entered an award rejecting the plaintiffs' claims, ruling that they did not sue the correct party. Plaintiffs continue to assert claims under PAGA that are not subject to arbitration.

*Adrian Mercedes Vasquez, an individual and on behalf of others similarly situated, v. California Cemetery and Funeral Services, LLC, et al*; Case No. BC58837; in the Superior Court of the State of California for the County of Los Angeles. This lawsuit was filed in July 2015 against SCI subsidiaries and purports to be brought on behalf of the defendants' current and former non-exempt California employees during the four years preceding the filing of the complaint. The plaintiff alleges numerous causes of action for alleged wage and hour pay violations. The plaintiff seeks unpaid wages, compensatory and punitive damages, civil penalties, attorneys' fees and costs, interest, and injunctive relief. The claims have been ordered to arbitration and the arbitrator has determined that the claims will proceed as a bilateral proceeding. In addition, the plaintiff filed an unfair labor practice charge against defendants with the National Labor Relations Board alleging that by enforcing a mandatory arbitration provision, defendants allegedly violated the National Labor Relations Act.

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*Lisa Fredeen, an aggrieved employee and on behalf of other aggrieved employees v. California Cemetery and Funeral Services, LLC, et al*; Case No. BC706930; in the Superior Court of the State of California for the County of Los Angeles. This lawsuit was filed on May 18, 2018, by the same law firm that filed the Vasquez case described above against SCI subsidiaries, asserting claims for violations of the California Labor Code and PAGA, based on alleged facts similar to those alleged in the Vasquez suit. The plaintiff seeks civil penalties, interest and attorneys' fees.

*Nicole Romano, individually and on behalf of all others similarly situated v. SCI Direct, Inc., et al*; Case No. BC656654; in the Superior Court of California for the County of Los Angeles. This lawsuit was filed in April 2017 against SCI subsidiaries and purports to have been brought on behalf of persons who worked as independent sales representatives in the U.S. during the four years preceding the filing of the complaint. In addition, this lawsuit also asserts claims under PAGA provisions on behalf of other similarly situated California persons. The plaintiff alleges numerous causes of action for alleged wage and hour pay violations, including misclassifying the independent sales representatives as independent contractors instead of employees. The plaintiff seeks unpaid wages, compulsory and punitive damages, attorneys' fees and costs, interest, and injunctive relief.

*James Doyle, individually and on behalf of all others similarly situated v. SCI Direct, Inc., et al*; Case No. 2:18-cv-05859 in the United States District Court Central District of California, removed from Case No. BC705666; in the Superior Court of California for the County of Los Angeles. This lawsuit was filed in May 2018, against an SCI subsidiary, by the same attorneys who filed the Romano case described above, and alleges causes of action and seeks damages and relief similar to those in the Romano case.

*Felicia Horton, an individual and on behalf of other aggrieved employees v. SCI Direct, Inc., et al*; Case No. 37-2016-00039356-CU-OE-CTL; in the Superior Court of California for the County of San Diego. This lawsuit was filed in November 2016, against SCI subsidiaries, on behalf of the plaintiff who worked as an independent sales representative of our subsidiary in California. In addition, this lawsuit asserts claims under PAGA on behalf of other similarly situated California persons. The lawsuit alleges causes of action and seeks damages and relief similar to those in the Romano case described above. The attorneys in the Horton case have also filed an additional lawsuit, against SCI subsidiaries, alleging individual and PAGA claims similar to those alleged in the Horton case. The additional lawsuits are styled *Jandy Quismundo v. SCI Direct, Inc., et al*; Case No. 37-2017-00031825-CU-OE-CTL; in the Superior Court of California for the County of San Diego, and *Jaime Kallweit v. SCI Direct, Inc., et al*; Case No. 37-2017-00037186-CU-OE-CTL; in the Superior Court for the State of California for the County of San Diego.

Claims Regarding Acquisition of Stewart Enterprises. We are involved in the following lawsuit.

*Karen Moulton, Individually and on behalf of all others similarly situated v. Stewart Enterprises, Inc., Service Corporation International and others*; Case No. 2013-5636; in the Civil District Court Parish of New Orleans, Louisiana. This case was filed as a class action in June 2013 against SCI and our subsidiary in connection with SCI's acquisition of Stewart Enterprises, Inc. The plaintiffs allege that SCI aided and abetted breaches of fiduciary duties by Stewart Enterprises and its board of directors in negotiating the combination of Stewart Enterprises with a subsidiary of SCI. The plaintiffs seek damages concerning the combination. We filed exceptions to the plaintiffs' complaint that were granted in June 2014. Thus, subject to appeals, SCI will no longer be party to the suit. The case has continued against our subsidiary Stewart Enterprises and its former individual directors. However, in October 2016, the court entered a judgment dismissing all of plaintiffs' claims. Plaintiffs have appealed the dismissal. Given the nature of this lawsuit, we are unable to reasonably estimate the possible loss or ranges of loss, if any.

Operational Claims. We are named a defendant in various lawsuits alleging operational claims, including but not limited to the Bernstein lawsuit described below.

*Caroline Bernstein, on behalf of herself and Marla Urofsky on behalf of Rhea Schwartz, and both on behalf of all others similarly situated v. SCI Pennsylvania Funeral Services, Inc. and Service Corporation International*, Case No. 2:17-cv-04960-GAM; in the United States District Court Eastern District of Pennsylvania. This case was filed in November 2017 as a purported national or alternatively as a Pennsylvania class action regarding our Forest Hills/Shalom Memorial Park in Huntingdon Valley, Pennsylvania and our Roosevelt Memorial Park Cemetery in Treose, Pennsylvania. Plaintiffs allege wrongful burial and sales practices. Plaintiffs seek compensatory, consequential and punitive damages, attorneys' fees and costs, interest, and injunctive relief. Given the nature of this lawsuit, we are unable to reasonably estimate the possible loss or ranges of loss, if any.

Unclaimed Property Audit. We are involved in the following matter.

We received notices from a third party auditor representing unclaimed property departments of certain states regarding preneed funeral and cemetery contracts that were not funded by the purchase and assignment of the proceeds of insurance policies. The auditor claims that we are subject to the laws of those states concerning escheatment of funds from the portion of such contracts for which it claims that we will probably not be required

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to provide services or merchandise in the future. No actual audits have commenced at this time. Given the nature of this lawsuit, we are unable to reasonably estimate the possible loss or ranges of loss, if any.

We intend to vigorously defend all of the above matters; however, an adverse decision in one or more of such matters could have a material effect on us, our financial condition, results of operations, and cash flows.

#### Other Potential Contingencies

In October of 2018, we received a letter from the Illinois Office of the Comptroller claiming that we improperly withdrew a total of \$13.6 million from perpetual care trusts covering 24 of its cemeteries in Illinois. We believe these withdrawals were entirely proper for the ongoing care of those cemeteries under Illinois law. We intend to vigorously defend its withdrawal of those funds.

### 10. Earnings Per Share

Basic earnings per common share (EPS) excludes dilution and is computed by dividing *Net income attributable to common stockholders* 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 shares that then shared in our earnings.

A reconciliation of the numerators and denominators of the basic and diluted EPS computations is presented below:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
(In thousands, except per share amounts)				
Amounts attributable to common stockholders:				
Net income:				
Net income — basic	\$ 68,935	\$ 56,164	\$ 254,162	\$ 299,347
After tax interest on convertible debt	15	13	45	38
Net income — diluted	\$ 68,950	\$ 56,177	\$ 254,207	\$ 299,385
Weighted average shares (denominator):				
Weighted average shares — basic	180,858	187,435	182,859	187,761
Stock options	4,284	4,575	4,364	4,448
Restricted stock units	197	112	173	87
Convertible debt	121	121	121	121
Weighted average shares — diluted	185,460	192,243	187,517	192,417
Net income per share:				
Basic	\$ 0.38	\$ 0.30	\$ 1.39	\$ 1.59
Diluted	\$ 0.37	\$ 0.29	\$ 1.36	\$ 1.56

The computation of diluted EPS excludes outstanding stock options in certain periods in which the inclusion of such options would be anti-dilutive in the periods presented. Total options not included in the computation of dilutive EPS are as follows (in shares):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
(In thousands)				
Anti-dilutive options	831	—	980	878

### 11. Acquisitions and Divestiture-Related Activities

#### *Acquisitions*

In June 2018, we acquired fifteen funeral homes and seven cemeteries in four states (the “acquired businesses”) for \$82.2 million in cash. Additionally, we paid \$49.8 million of the acquired businesses existing debt in conjunction with the closing of the acquisition.

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The primary reasons for the acquisition and the principal factors that contributed to the recognition of goodwill in this acquisition were:

- the acquisition enhances our network footprint, enabling us to serve a number of new, complementary areas and
- the acquisition of the preneed backlog of deferred revenues enhances our long-term stability.

The following table summarizes the preliminary fair values of the assets acquired and liabilities assumed in the acquisition (in thousands):

	(in thousands)
Other current assets	\$ 2,881
Cemetery property	28,683
Property and equipment, net	25,717
Preneed receivables, net and trust investments	102,720
Finite-lived intangible assets	47,017
Indefinite-lived intangible assets	18,000
Deferred charges and other assets	1,717
Cemetery perpetual care trust investments	53,027
Goodwill	27,416
<b>Total assets acquired</b>	<b>307,178</b>
Current liabilities	4,205
Deferred revenue and deferred receipts held in trust	112,874
Deferred income taxes	5,064
Care trusts' corpus	53,027
<b>Total liabilities assumed</b>	<b>175,170</b>
<b>Net assets acquired</b>	<b>\$ 132,008</b>

The purchase accounting adjustments are preliminary as we have not finalized our assessment of the fair value as there has been insufficient time between the acquisition date and the issuance of these financial statements to complete our review and final determination of fair value.

Included in preneed receivables, net and trust investments are receivables under preneed contracts with a fair value of \$3.8 million. The gross amount due under the contracts is \$4.3 million, of which \$0.5 million is not expected to be collected.

Goodwill, land, and certain identifiable intangible assets recorded in the acquisition are not subject to amortization; however, the goodwill and intangible assets will be tested periodically for impairment. Of the \$27.4 million in goodwill recognized, \$15.3 million was allocated to our cemetery segment and \$12.1 million was allocated to our funeral segment. Additionally, \$15.7 million of this goodwill is deductible for tax purposes. The identified intangible assets comprise the following:

	Useful life		Fair Value (In thousands)
	Minimum	Maximum	
	(Years)		
Other preneed customer relationships	10	20	\$ 23,993
Selling and management agreements	89	89	13,176
Operating leases	89	89	2,848
Tradenames	89	89	7,000
Tradenames		Indefinite	18,000
<b>Total intangible assets</b>			<b>\$ 65,017</b>

We incurred acquisition costs of \$2.2 million, which are included in *General and administrative expenses*. The acquired businesses contributed revenue of \$10.4 million and net income of \$1.1 million for the period from June 8, 2018 through September 30, 2018.

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Proforma summary results for the twelve months ended December 31, 2017 and the nine months ended September 30, 2018 have not been provided as it is impracticable to do so given the extent of integration activities to date.

**Divestiture-Related Activities**

As divestitures occur in the normal course of business, gains or losses on the sale of such assets are recognized in the income statement line item *Gains (losses) on divestitures and impairment charges, net*, which consist of the following:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
	(In thousands)			
Gains (losses) on divestitures, net	\$ 8,058	\$ (62)	\$ 16,199	\$ 22,611
Impairment losses	(88)	(81)	(882)	(17,066)
Gains (losses) on divestitures and impairment charges, net	\$ 7,970	\$ (143)	\$ 15,317	\$ 5,545

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

We are North America's largest provider of deathcare products and services, with a network of funeral service locations and cemeteries unequaled in geographic scale and reach. At September 30, 2018, we operated 1,478 funeral service locations and 481 cemeteries (including 286 funeral service/cemetery combination locations), which are geographically diversified across 44 states, eight Canadian provinces, the District of Columbia, and Puerto Rico.

We are well known for our Dignity Memorial® brand, North America's first transcontinental brand of deathcare products and services. Our other brands are Dignity Planning™, National Cremation Society®, Advantage® Funeral and Cremation Services, Funeraria del Angel™, Making Everlasting Memories®, Neptune Society™, and Trident Society™. Our funeral and cemetery operations consist of funeral service locations, cemeteries, funeral service/cemetery combination locations, crematoria, and related businesses, which enable us to serve a wide array of customer needs. We sell cemetery property and funeral and cemetery merchandise and services at the time of need and on a preneed basis.

Our financial position is enhanced by our approximately \$11.3 billion backlog of future revenue from both trust and insurance-funded preneed sales at September 30, 2018. Preneed selling provides us with a strategic opportunity to lock-in future market share while deterring the customer from going to a competitor in the future. We also believe it adds to the stability and predictability of our revenue and cash flows. While revenue on the majority of preneed merchandise and service sales is deferred until the time of need, sales of preneed cemetery property provide opportunities for full current revenue recognition to the extent that the property is developed and available for use.

We have adequate liquidity and a favorable debt maturity profile, which allow us to return capital to shareholders through share repurchases and dividends.

Factors affecting our operating results include: demographic trends in terms of population growth and average age, which impact death rates and number of deaths; establishing and maintaining leading market share positions supported by strong local heritage and relationships; effectively responding to increasing cremation trends by selling complementary services and merchandise; controlling salary and merchandise costs; and exercising pricing leverage related to our at-need revenue. The average revenue per funeral contract is influenced by the mix of traditional and cremation services because our average cremation service revenue is approximately half of the average revenue earned from a traditional burial service. To further enhance revenue opportunities, we continue to focus on our cremation customer's preferences and remaining relevant by developing additional memorialization merchandise and services that specifically appeal to cremation customers. We believe the presentation of these additional merchandise and services through our customer-facing technology enhances our customer's experience by reducing administrative burdens and allowing them to visualize the product offerings and services, which will help drive increases in the average revenue for a cremation in future periods.

For further discussion of our key operating metrics, see our *Results of Operations* and *Cash Flow* sections below.

**Financial Condition, Liquidity and Capital Resources****Capital Allocation Considerations**

We rely on cash flow from operations as a significant source of liquidity. Our cash flow from operating activities provided \$452.3 million in the first nine months of 2018. We have \$571.7 million in borrowing capacity under our bank credit facility.

Our bank credit agreement requires us to maintain certain leverage and interest coverage ratios. As of September 30, 2018, we were in compliance with all of our debt covenants. Our financial covenant requirements and actual ratios as of September 30, 2018 are as follows:

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	<u>Per Credit Agreement</u>	<u>Actual</u>
Leverage ratio	4.50 (Max)	3.86
Interest coverage ratio	3.00 (Min)	5.23

We believe that our unencumbered cash on hand, future operating cash flows, and the available capacity under our bank credit agreement will give us adequate liquidity to meet our short-term needs as well as our long-term financial obligations. Due to cash balances residing in Canada and expected minimum operating cash in transit, a portion of our cash on hand is encumbered.

We consistently evaluate the best uses of our cash flow that will yield the highest value and return on capital. Our capital deployment strategy is prioritized as follows:

**Invest in acquisitions and new builds.** We intend to make acquisitions of funeral service locations and cemeteries when pricing and terms are favorable. We expect an acquisition investment to earn an after-tax cash return in excess of our weighted average cost of capital with room for execution risk. We will also invest in the construction of funeral service locations. We target businesses with favorable customer segments and/or where we can achieve additional economies of scale.

**Pay a dividend.** Our quarterly dividend rate has steadily grown from \$0.025 per common share in 2005 to \$0.17 per common share in 2018. We target a payout ratio of 30% to 40% and intend to grow our cash dividend commensurate with the growth in our business. While we intend to pay regular quarterly cash dividends for the foreseeable future, all future dividends are subject to limitations in our debt covenants and final determination by our Board of Directors each quarter upon review of our financial performance.

**Repurchase shares.** Absent a strategic acquisition opportunity, we believe share repurchases are attractive at the appropriate price. During the nine months ended September 30, 2018, we repurchased 7,301,736 shares of common stock at an aggregate cost of \$275.7 million, which is an average cost per share of \$37.76. After these repurchases, the remaining dollar value of shares authorized to be purchased under our share repurchase program was approximately \$194.4 million at September 30, 2018. We intend to make purchases from time to time in the open market or through privately negotiated transactions, subject to market conditions, debt covenants, and normal trading restrictions. Our bank credit agreement contains covenants that limit our ability to repurchase our common stock. There can be no assurance that we will buy our common stock under our share repurchase program in the future.

**Repurchase debt.** We seek open market debt repurchases when it is opportunistic to do so relative to other capital development opportunities to manage our near-term debt maturity profile. We have a relatively consistent annual cash flow stream that is generally resistant to down economic cycles. This cash flow stream and our significant liquidity are available to substantially reduce our long-term debt maturities should we choose to do so. Furthermore, our capital expenditures are generally discretionary in nature and can be managed based on the availability of operating cash flow.

### **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 our operating, investing, and financial needs.

#### *Operating Activities*

Net cash provided by operating activities increased \$62.8 million to \$452.3 million in the first nine months of 2018, compared to \$389.5 million in the first nine months of 2017. The current period includes a \$5.6 million tax refund related to the March 2017 settlement of audits for tax years 1999-2005. The prior year includes \$34.2 million cash taxes paid in 2017 related to the March 2017 settlement of audits for tax years 1999-2005 (see Part I, Item 1. Financial Statements, Note 4 for more information) and \$6.3 million in pension termination settlement payments.

Excluding the above items, cash flow from operations increased \$16.7 million from the prior year as a result of the following:

- a \$70.7 million increase in cash receipts from customers,
- a \$3.7 million increase in net trust withdrawals,
- a \$3.3 million increase in hurricane insurance proceeds,
- a \$7.1 million increase in General Agency (GA) and other receipts, and
- a \$31.4 million decrease in cash tax payments as a result of the impact of recently enacted tax reform and effective tax planning, excluding the tax items noted above, partially offset by:
  - a \$54.6 million increase in vendor and other payments,
  - a \$33.5 million increase in employee compensation paid, and
  - a \$11.4 million increase in cash interest paid.

[Table of Contents](#)*Investing Activities*

Cash flows from investing activities used \$346.8 million in the first nine months of 2018 compared to using \$188.3 million in the same period of 2017. The \$158.5 million increase from 2018 over 2017 is primarily due to the following:

- a \$2.7 million decrease in cash receipts from divestitures and asset sales,
- a \$111.8 million increase in cash spent on acquisitions,
- a \$24.3 million increase in capital expenditures primarily due to improvements at existing funeral homes,
- a \$14.7 million increase primarily for the purchase of land, and
- a \$7.9 million increase in payments for Company-owned life insurance policies, net of proceeds, partially offset by
  - a \$2.9 million increase in proceeds from sale of other investments.

*Financing Activities*

Financing activities used \$279.1 million in the first nine months of 2018 compared to using \$147.5 million in the same period of 2017. The \$131.6 million increase from 2018 over 2017 is primarily due to the following:

- a \$126.9 million increase in purchase of Company common stock, and
- a \$12.3 million increase in payments of dividends, and
- a \$12.2 million decrease in proceeds from exercises of stock options, and
- a \$11.6 million decrease in bank overdrafts and other, partially offset by
  - a \$26.9 million increase in net debt issuance proceeds, net of payments, and
  - a \$4.6 million decrease in purchase of non-controlling interest.

*Financial Assurances*

In support of our operations, we have entered into arrangements with certain surety companies whereby such companies agree to issue 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 obligations underlying these surety bonds are recorded on the unaudited Condensed Consolidated Balance Sheet as *Deferred revenue, net*. The breakdown of surety bonds between funeral and cemetery preneed arrangements, as well as surety bonds for other activities, is described below.

	September 30, 2018	December 31, 2017
	(In millions)	
Preneed funeral	\$ 107.6	\$ 109.8
Preneed cemetery:		
Merchandise and services	138.0	132.2
Pre-construction	15.2	11.9
Bonds supporting preneed obligations	260.8	253.9
Bonds supporting preneed business permits	4.7	4.5
Other bonds	18.8	18.0
Total surety bonds outstanding	\$ 284.3	\$ 276.4

When selling preneed contracts, we may post surety bonds where allowed by state law. 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. For the nine months ended September 30, 2018 and 2017, we had \$18.1 million and \$17.6 million, respectively, of cash receipts attributable to bonded sales. These amounts do not consider reductions associated with taxes, obtaining costs, or other costs.

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 pre-construction 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 were 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 that we will be required to fund material future amounts related to these surety bonds because of lack of surety capacity or surety company non-performance.

*Preneed Funeral and Cemetery Activities and Backlog of Contracts*

In addition to selling our products and services to client families at the time of need, we enter into price-guaranteed preneed contracts, which provide for future funeral or cemetery merchandise and services. Because preneed funeral and

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cemetery merchandise or services will generally not be provided until sometime in the future, most states and provinces require that all or a portion of the funds collected from customers on preneed contracts be deposited into merchandise and service trusts until the merchandise is delivered or the service is performed. In certain situations, as described above, where permitted by state or provincial laws, we may post a surety bond as financial assurance for a certain amount of the preneed contract in lieu of placing funds into trust accounts. Alternatively, we may sell a life insurance or annuity policy from third-party insurance companies.

*Insurance-Funded Preneed Contracts:* Where permitted by state or provincial law, we may sell a life insurance or annuity policy from third-party insurance companies, for which we earn a commission as general sales agent for the insurance company. These general agency commissions (GA revenue) are based on a percentage per contract sold and are recognized as funeral revenue when the insurance purchase transaction between the preneed purchaser and third-party insurance provider is completed. All selling costs incurred pursuant to the sale of insurance-funded preneed contracts are expensed as incurred. We do not reflect the unfulfilled insurance-funded preneed contract amounts in our unaudited Condensed Consolidated Balance Sheet. The proceeds of the life insurance policies or annuity contracts will be reflected in funeral revenue as we perform these funerals.

The table below details the results of insurance-funded preneed production and maturities for the three and nine months ended September 30, 2018 and 2017, and the number of contracts associated with those transactions.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In millions)			
<b>Preneed insurance-funded:</b>				
Sales production <sup>(1)</sup>	\$ 144.1	\$ 124.9	\$ 418.8	\$ 386.2
Sales production (number of contracts) <sup>(1)</sup>	25,007	21,297	71,828	64,305
General agency revenue	\$ 34.6	\$ 29.1	\$ 102.2	\$ 90.9
Maturities	\$ 77.9	\$ 77.4	\$ 257.0	\$ 249.5
Maturities (number of contracts)	13,387	13,061	43,638	42,144

<sup>(1)</sup> Amounts are not included in our unaudited Condensed Consolidated Balance Sheet.

*Trust-Funded Preneed Contracts:* The funds collected from customers and required by state or provincial law are deposited into trusts. 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 our preneed programs. Although this represents cash flow to us, the associated revenues are deferred until the merchandise is delivered or services are performed (typically at maturity). The funds in trust are then invested by professional money managers with oversight by independent trustees in accordance with state and provincial laws.



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The tables below detail our results of preneed production and maturities, excluding insurance contracts, for the three and nine months ended September 30, 2018 and 2017.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
(In millions)				
<b>Funeral:</b>				
Preneed trust-funded (including bonded):				
Sales production	\$ 88.5	\$ 76.6	\$ 273.5	\$ 241.1
Sales production (number of contracts)	23,476	22,451	74,472	72,112
Maturities	\$ 67.8	\$ 64.0	\$ 215.4	\$ 195.7
Maturities (number of contracts)	16,649	16,065	53,492	50,897
<b>Cemetery:</b>				
Sales production:				
Preneed	\$ 209.6	\$ 194.8	\$ 656.7	\$ 638.3
Atneed	76.4	74.6	241.4	237.8
Total sales production	\$ 286.0	\$ 269.4	\$ 898.1	\$ 876.1
Sales production deferred to backlog:				
Preneed	\$ 104.0	\$ 91.5	\$ 321.4	\$ 292.2
Atneed	56.7	55.2	179.4	173.9
Total sales production deferred to backlog	\$ 160.7	\$ 146.7	\$ 500.8	\$ 466.1
Revenue recognized from backlog:				
Preneed	\$ 100.3	\$ 79.9	\$ 238.5	\$ 210.6
Atneed	56.6	55.8	177.0	171.4
Total revenue recognized from backlog	\$ 156.9	\$ 135.7	\$ 415.5	\$ 382.0

*Backlog of Preneed Contracts:* The following table reflects our backlog of trust-funded deferred preneed contract revenue, including amounts related to *Deferred receipts held in trust* at September 30, 2018 and December 31, 2017. Additionally, the table reflects our backlog of unfulfilled insurance-funded contracts (which are not included in our unaudited Condensed Consolidated Balance Sheet) at September 30, 2018 and December 31, 2017. The backlog amounts presented include amounts due from customers for undelivered performance obligations on cancelable preneed contracts to arrive at our total backlog of deferred revenue. The table does not include the backlog associated with businesses that are held for sale.

The table also reflects our preneed receivables and trust investments associated with the backlog of deferred preneed contract revenue including the amounts due from customers for undelivered performance obligations on cancelable preneed contracts. We believe that the table below is meaningful because it sets forth the aggregate amount of future revenue we expect to recognize as a result of preneed sales, as well as the amount of funds associated with this revenue. Because the future revenue exceeds the assets, future revenue will exceed the cash distributions actually received from the associated trusts and future collections from the customer.

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	September 30, 2018		December 31, 2017	
	Fair Value	Cost	Fair Value	Cost
	(In billions)			
Deferred revenue, net	\$ 1.43	\$ 1.43	\$ 1.79	\$ 1.79
Amounts due from customers for unfulfilled performance obligations on cancelable preneed contracts <sup>(1)</sup>	0.57	0.57	—	—
Deferred receipts held in trust	3.69	3.41	3.48	3.18
Allowance for cancellation	(0.29)	(0.27)	(0.27)	(0.25)
Backlog of trust-funded deferred revenue, net of estimated allowance for cancellation	\$ 5.40	\$ 5.14	\$ 5.00	\$ 4.72
Backlog of insurance-funded deferred revenue <sup>(2)</sup>	5.93	5.93	5.66	5.66
Total backlog of deferred revenue	\$ 11.33	\$ 11.07	\$ 10.66	\$ 10.38
Preneed receivables, net and trust investments	\$ 4.57	\$ 4.29	\$ 4.78	\$ 4.48
Amounts due from customers for unfulfilled performance obligations on cancelable preneed contracts <sup>(1)</sup>	0.57	0.57	—	—
Allowance for cancellation on trust investments	(0.29)	(0.27)	(0.27)	(0.25)
Assets associated with backlog of trust-funded deferred revenue, net of estimated allowance for cancellation	\$ 4.85	\$ 4.59	\$ 4.51	\$ 4.23
Insurance policies associated with insurance-funded deferred revenue <sup>(2)</sup>	5.93	5.93	5.66	5.66
Total assets associated with backlog of preneed deferred revenue	\$ 10.78	\$ 10.52	\$ 10.17	\$ 9.89

(1) Prior to adoption of "Revenue from Contracts with Customers" on January 1, 2018, amounts due from customers for unfulfilled performance obligations on cancelable preneed contracts were included in Preneed receivables, net and trust investments.

(2) Amounts are not included in our unaudited Condensed Consolidated Balance Sheet.

The fair value of our trust investments was based on a combination of quoted market prices, observable inputs such as interest rates or yield curves, and appraisals. As of September 30, 2018, the difference between the backlog and asset fair value amounts totaled \$0.55 billion, consisting of \$0.25 billion related to contracts for which we have posted surety bonds as financial assurance in lieu of trusting, \$0.09 billion collected from customers that were not required to be deposited into trust, and \$0.21 billion in allowable cash distributions from trust assets. As of September 30, 2018, the fair value of the total backlog comprised \$3.02 billion related to cemetery contracts and \$8.31 billion related to funeral contracts. As of September 30, 2017, the fair value of the assets associated with the backlog of trust-funded deferred revenue comprised \$2.77 billion related to cemetery contracts and \$2.08 billion related to funeral contracts.

**Trust Investments**

In addition to selling our products and services to client families at the time of need, we enter into price-guaranteed preneed funeral and cemetery contracts, which provide for future funeral or cemetery merchandise and services. Because preneed funeral and cemetery merchandise or services will generally not be provided until sometime in the future, most states and provinces require that all or a portion of the funds collected from customers on preneed funeral and cemetery contracts be paid into trusts and/or escrow accounts until the merchandise is delivered or the service is performed. Investment earnings associated with the trust investments are expected to mitigate the inflationary costs of providing the preneed funeral and cemetery merchandise and services in the future at the prices that were guaranteed at the time of sale.

Also, we are required by state and provincial law to pay a portion of the proceeds from the preneed or atneed sale of cemetery property interment rights into cemetery perpetual care trusts. For these investments, the original corpus remains in the trust in perpetuity and the net ordinary earnings or elected distributions are withdrawn with the intention of offsetting the expense to maintain the cemetery property. While many states require that net capital gains or losses be retained and added to the corpus, certain states allow the net realized capital gains and losses to be included in the net ordinary earnings that are distributed. Additionally, some states allow a total return distribution that may contain elements of income, capital appreciation, and principal.

Independent trustees manage and invest the majority of the funds deposited into the funeral and cemetery merchandise and services trusts as well as the cemetery perpetual care trusts. The majority of trustees are selected based on their respective geographic footprint and qualifications per state and provincial regulations. Most of the trustees engage the same independent investment managers. These trustees, with input from SCI's wholly-owned registered investment advisor, establish an investment policy that serves as an operating document to guide the investment activities of the trusts including asset allocation and manager selection. The investments are also governed by state and provincial guidelines. All of the trusts seek to control risk and volatility through a combination of asset classes, investment styles, and a diverse mix of investment managers.

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Asset allocation is based on the liability structure of each funeral, cemetery, and perpetual care trust. Based on the various criteria set forth in the investment policy, the investment advisor recommends investment managers to the trustees. The primary investment objectives for the funeral and cemetery merchandise and service trusts include 1) preserving capital within acceptable levels of volatility and risk and 2) achieving growth of principal over time sufficient to preserve and increase the purchasing power of the assets. Preneed funeral and cemetery contracts generally take years to mature; therefore, the funds associated with these contracts are often invested through several market cycles.

Historically, the cemetery perpetual care trusts' investment objectives, in accordance with state and provincial regulations, have emphasized providing a steady stream of current investment income with some capital appreciation to provide for the maintenance and beautification of cemetery properties. However, beginning in 2016, we worked with several state legislatures to adjust laws and regulations to allow for a fixed distribution rate from cemetery perpetual care trusts' assets regardless of the level of ordinary income, similar to university endowments. As a result, beginning in 2017, a significant portion of our cemetery perpetual care trust assets were liquidated and reinvested in a more growth-oriented asset allocation with investment objectives similar to the funeral and cemetery merchandise and service trusts. Currently, the asset allocation is split approximately evenly between income and growth orientations. We expect this asset allocation shift to enhance asset growth and provide further protection to our customers. Additionally, we expect more states to adopt total return distribution legislation in the coming years.

As of September 30, 2018, approximately 86% of our trusts were under the control and custody of three large financial institutions. The U.S. trustees primarily use four managed limited liability companies (LLCs), one for each merchandise and service trust type and two for the cemetery perpetual care trust type, and each with an independent trustee as custodian. Each financial institution acting as trustee manages its allocation of trust assets in accordance with the investment policy through the purchase of the LLCs' units. For those accounts not eligible for participation in the LLCs, or in the event a particular state's regulations contain investment restrictions, the trustee utilizes institutional mutual funds that comply with our investment policy or with such state restrictions. The U.S. trusts include a modest allocation to alternative investments. These alternative investments are held in vehicles structured as LLCs and are managed by certain trustees. The trusts that are eligible to allocate a portion of their investments to alternative investments purchase units of the respective alternative investment LLCs.

### *Investment Structures*

Each financial institution, acting as trustee, manages its allocation of trust assets in compliance with the investment policy primarily through the purchase of four managed LLCs, one for each trust type and each with a different, independent trustee acting as custodian. The managed LLCs use the following structures for investments:

*Commingled funds.* These funds allow the trusts to access, at a reduced cost, the same investment managers and strategies used elsewhere in the portfolios.

*Mutual funds.* The trust funds employ institutional share class mutual funds where operationally or economically efficient. These mutual funds are utilized to invest in various asset classes including U.S. equities, non-U.S. equities, corporate bonds, government bonds, high yield bonds, and commodities, all of which are governed by guidelines outlined in their individual prospectuses.

*Separately managed accounts.* To reduce the costs to the investment portfolios, the trusts utilize separately managed accounts where appropriate.

### *Asset Classes*

*Fixed income investments* are intended to preserve principal, provide a source of current income, and reduce overall portfolio volatility. The majority of the fixed income allocation for the trusts is in institutional share class mutual funds. Where the trusts have direct investments in individual fixed income securities, these are primarily in government and corporate instruments.

Canadian government fixed income securities are investments in Canadian federal and provincial government instruments. In many cases, regulatory restrictions mandate that the funds from the sales of preneed funeral and cemetery products sold in certain Canadian jurisdictions must be invested in these instruments.

*Equity investments* have historically provided long-term capital appreciation in excess of inflation. The trusts have direct investments in individual equity securities primarily in domestic equity portfolios that include large, mid, and small capitalization companies of different investment styles (i.e., growth and value). The majority of the equity allocation is managed by institutional investment managers that specialize in an objective-specific area of expertise. Our equity securities are exposed to market risk; however, we believe these securities are well-diversified. As of September 30, 2018, the largest single equity position represented less than 1% of the total securities portfolio.

The objective of *private equity fund* investments is to provide high rates of return with reduced volatility and lower correlation. These investments are typically long term in duration. These investments are diversified by strategy, sector, manager, and vintage year. The investments consist of numerous limited partnerships, including private equity, real estate, fund of funds, distressed debt, and mezzanine financing. The trustees that have oversight of their respective alternative LLCs work closely with the investment advisor in making all investment decisions.

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*Trust Performance*

During the nine months ended September 30, 2018, the Standard and Poor's 500 Index increased 10.6% and the Barclay's Aggregate Index decreased 1.6%, while the combined SCI trusts increased 4.4%.

SCI, the trustees, and the investment advisor monitor the capital markets and the trusts on an on-going basis. The trustees, with input from the investment advisor, take prudent action as needed to achieve the investment goals and objectives of the trusts.

**Results of Operations — Three Months Ended September 30, 2018 and 2017**

**Management Summary**

In the three months ended September 30, 2018, we reported net income attributable to common stockholders of \$68.9 million (\$0.37 per diluted share) compared to net income attributable to common stockholders for the same period in 2017 of \$56.2 million (\$0.29 per diluted share). These results were affected by the following items:

	Three Months Ended September 30,	
	2018	2017
	(In millions)	
Pre-tax gains (losses) from divestitures and impairment charges, net	\$ 8.0	\$ (0.1)
Pre-tax legal settlement	\$ —	\$ (11.5)
Tax (provision for) benefit from above items	\$ (0.8)	\$ 4.0
Change in certain tax reserves and other	\$ (2.6)	\$ 0.8

In addition to the above items, the increase in diluted earnings per share was primarily driven by solid funeral and cemetery results, the impact of new accounting standards and selling processes, a lower effective tax rate, and a lower share count, partially offset by higher interest expense.

**Funeral Results**

	Three Months Ended September 30,	
	2018	2017
	(Dollars in millions, except average revenue per service)	
Consolidated funeral revenue	\$ 451.0	\$ 437.5
Less: Revenue associated with acquisitions/new construction	12.3	4.4
Less: Revenue associated with divestitures	0.3	2.9
Comparable <sup>(1)</sup> funeral revenue	438.4	430.2
Less: Comparable recognized preneed revenue	31.5	26.6
Less: Comparable general agency and other revenue	32.1	28.6
Adjusted comparable funeral revenue	\$ 374.8	\$ 375.0
Comparable services performed	70,460	70,805
Comparable average revenue per service <sup>(2)</sup>	\$ 5,319	\$ 5,296
Consolidated funeral operating profit	\$ 68.1	\$ 70.1
Less: Operating profit associated with acquisitions/new construction	0.8	0.7
Less: Operating loss associated with divestitures	(0.2)	(1.2)
Comparable funeral operating profit	\$ 67.5	\$ 70.6

(1) We define comparable (or same store) operations as those funeral locations owned by us for the entire period beginning January 1, 2017 and ending September 30, 2018.

(2) We calculate comparable average revenue per service by dividing comparable funeral revenue, excluding recognized preneed revenue, general agency revenue, and other revenue to avoid distorting our average of normal funeral services revenue, by the comparable number of services performed during the period. Recognized preneed revenue represents travel protection, net and merchandise sold on a preneed contract and delivered before death has occurred, and is excluded from our calculation of comparable average revenue per service because the associated service has not yet been performed.

*Funeral Revenue*

Consolidated revenue from funeral operations was \$451.0 million for the three months ended September 30, 2018 compared to \$437.5 million for the same period in 2017. This increase is primarily attributable to a \$8.2 million increase in comparable revenue as described below and \$7.9 million in revenue contributed by acquired and newly constructed properties. These increases were partially offset by the loss of \$2.6 million in revenue contributed by properties that have been subsequently divested.

Comparable revenue from funeral operations was \$438.4 million for the three months ended September 30, 2018 compared to \$430.2 million for the same period in 2017. This \$8.2 million increase is due to a 0.4% increase in our total average revenue per funeral service, an increase in general agency revenue resulting from higher preneed funeral sales production, and an increase in recognized preneed revenue driven by an increase the number of contracts sold through our non-funeral home sales channel, partially offset by 0.5% lower comparable services performed.

An increase in the organic sales average was offset by a 160 basis point increase in our total cremation mix. Our total comparable cremation rate increased to 55.0% in the three months ended September 30, 2018 from 53.4% in 2017 as a result of an increase in both direct cremations and cremations with service.

*Funeral Operating Profit*

Consolidated funeral operating profit decreased \$2.0 million, or 2.9%, in the three months ended September 30, 2018 compared to the same period in 2017. This decrease is primarily attributable to a decrease in comparable funeral operating profit of \$3.1 million, or 4.4%. Comparable funeral operating profit decreased \$3.1 million to \$67.5 million and the operating margin percentage decreased 100 basis points to 15.4%. Our fixed costs in the funeral segment were higher by \$9.4 million, or 3.6%, as expected wage increases for critical customer-facing employees and higher self-insured medical claims added to the increase. Additionally, we experienced higher selling costs associated with marketing and sales lead procurement that we believe are benefiting funeral preneed sales production.

*Cemetery Results*

	Three Months Ended September 30,	
	2018	2017
	(In millions)	
Consolidated cemetery revenue	\$ 327.8	\$ 293.8
Less: Revenue associated with acquisitions	6.6	1.2
Less: Revenue associated with divestitures	0.1	0.5
Comparable <sup>(1)</sup> cemetery revenue	<u>\$ 321.1</u>	<u>\$ 292.1</u>
Consolidated cemetery operating profit	\$ 98.0	\$ 79.7
Less: Operating profit associated with acquisitions	1.6	0.5
Less: Operating profit (loss) associated with divestitures	0.3	(0.1)
Comparable cemetery operating profit	<u>\$ 96.1</u>	<u>\$ 79.3</u>

(1) We define comparable (or same store) operations as those cemetery locations owned by us for the entire period beginning January 1, 2017 and ending September 30, 2018.

*Cemetery Revenue*

Consolidated revenue from our cemetery operations increased \$34.0 million, or 11.6%, in the third quarter of 2018 compared to the same period in 2017 primarily due to a \$29.0 million increase in comparable cemetery revenue described below and \$5.4 million in revenue contributed by acquired properties. The increase in comparable revenue over the prior year quarter is primarily due to an increase in sales production, the completion of cemetery property construction projects that were previously sold, and higher other revenue (primarily endowment care trust fund income).

*Cemetery Operating Profit*

Consolidated cemetery operating profit increased \$18.3 million, or 23.0%, in the third quarter of 2018 compared to the same period in 2017. Comparable cemetery operating profit increased \$16.8 million to \$96.1 million and the operating margin percentage increased 280 basis points to 29.9%. The revenue increases mentioned above were partially offset by investments in digital marketing mentioned above, as well as higher labor costs due to permanent wage increases for certain of our critical customer-facing employees and higher self-insured medical claims.

**Other Financial Statement Items***General and Administrative Expenses*

General and administrative expenses increased \$2.1 million to \$41.1 million in the third quarter of 2018. The prior year quarter included a legal settlement for \$11.5 million. Excluding this legal settlement, general and administrative expenses were unfavorable by \$13.6 million primarily related to higher expenses for our long-term incentive compensation plan because the plan is tied to increases in total shareholder return.

*Gains (Losses) on Divestitures and Impairment Charges, Net*

Gains (losses) on divestitures increased \$8.1 million to \$8.0 million in the three months ended September 30, 2018 associated with the divestitures of non-strategic funeral and cemetery locations in the United States and Canada.

*Hurricane Expenses, Net*

Hurricane expenses, net, reflects \$0.8 million in expenses incurred in the three months ended September 30, 2018 as we continue repairs at various locations caused by the 2017 hurricanes and locations impacted by hurricanes in the current year.

Hurricane expenses, net, reflects \$1.3 million in expenses incurred in the three months ended September 30, 2017 as we experienced repairs at various locations caused by the 2017 hurricanes.

*Interest Expense*

Interest expense increased \$3.7 million to \$46.4 million in the third quarter of 2018 due to higher interest rates on our floating rate debt as well as an increase in the overall balance of our total debt.

*(Provision For) Benefit From Income Taxes*

Income tax expense during interim periods is based on our estimated annual effective income tax rate plus any discrete items, which are recorded in the period in which they occur. Discrete items include, among others, such events as changes in estimates due to the finalization of tax returns, tax audit settlements, expiration of statutes of limitation, and increases or decreases in valuation allowances on deferred tax assets. The GAAP effective income tax rate for the third quarter of 2018 was 19.8%, up from the third quarter rate of 15.7% for 2017. The increase in the rate from the prior year quarter was primarily the result of lower tax benefits recognized on the settlement of employee share-based awards.

*Weighted Average Shares*

The diluted weighted average number of shares outstanding was 185.5 million in the three months ended September 30, 2018, compared to 192.2 million in the same period in 2017. The decrease in the number of shares reflects the impact of shares repurchased under our share repurchase program.

**Results of Operations — Nine Months Ended September 30, 2018 and 2017****Management Summary**

In the nine months ended September 30, 2018, we reported net income attributable to common stockholders of \$254.2 million (\$1.36 per diluted share) compared to net income attributable to common stockholders for the same period in 2017 of \$299.3 million (\$1.56 per diluted share). These results were affected by the following items:

	<b>Nine Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
	<b>(In millions)</b>	
Pre-tax gains from divestitures and impairment charges, net	\$ 15.3	\$ 5.5
Pre-tax losses from the early extinguishment of debt, net	\$ (10.1)	\$ —
Pre-tax legal settlement	\$ —	\$ (11.5)
Pre-tax pension termination settlement	\$ —	\$ (12.8)
Tax (provision for) benefit from above items	\$ (1.4)	\$ 6.6
Change in certain tax reserves and other	\$ 14.8	\$ 108.0

After considering the impact of the items above, the increase in diluted earnings per share was primarily driven by solid funeral and cemetery results, the impact of new accounting standards and selling processes, and a lower share count, partially offset by higher interest expense.

**Funeral Results**

	Nine Months Ended September 30,	
	2018	2017
	(Dollars in millions, except average revenue per service)	
Consolidated funeral revenue	\$ 1,434.0	\$ 1,395.2
Less: Revenue associated with acquisitions/new construction	27.6	8.7
Less: Revenue associated with divestitures	2.3	11.5
Comparable <sup>(1)</sup> funeral revenue	1,404.1	1,375.0
Less: Comparable recognized preneed revenue	97.6	88.9
Less: Comparable general agency and other revenue	93.6	88.6
Adjusted comparable funeral revenue	\$ 1,212.9	\$ 1,197.5
Comparable services performed	228,949	226,624
Comparable average revenue per service <sup>(2)</sup>	\$ 5,298	\$ 5,284
Consolidated funeral operating profit	\$ 279.0	\$ 274.8
Less: Operating profit associated with acquisitions/new construction	2.5	2.0
Less: Operating loss associated with divestitures	(1.8)	(4.3)
Comparable funeral operating profit	\$ 278.3	\$ 277.1

(1) We define comparable (or same store) operations as those funeral locations owned by us for the entire period beginning January 1, 2017 and ending September 30, 2018.

(2) We calculate comparable average revenue per service by dividing comparable funeral revenue, excluding recognized preneed revenue, general agency revenue, and other revenue to avoid distorting our average of normal funeral services revenue, by the comparable number of services performed during the period. Recognized preneed revenue represents travel protection, net and merchandise sold on a preneed contract and delivered before death has occurred, and are excluded from our calculation of comparable average revenue per service because the associated service has not yet been performed.

**Funeral Revenue**

Consolidated revenue from funeral operations was \$1,434.0 million for the nine months ended September 30, 2018 compared to \$1,395.2 million for the same period in 2017. This increase is primarily attributable to a \$29.1 million increase in comparable revenue as described below and \$18.9 million in revenue contributed by acquired and newly constructed properties, partially offset by the loss of \$9.2 million in revenue contributed by properties that have been subsequently divested.

Comparable revenue from funeral operations was \$1,404.1 million for the nine months ended September 30, 2018 compared to \$1,375.0 million for the same period in 2017. The \$29.1 million increase was primarily due to a 1.0% increase in comparable services performed. The increase in services performed comprises a 0.9% increase in services performed by our funeral homes and a 2.1% increase in cremation services performed by our non-funeral home sales channel.

Average revenue per service was relatively flat as a slight increase in the organic sales average was offset by a 130 basis point increase in the core cremation mix. Our total comparable cremation rate increased to 54.6% in the nine months ended September 30, 2018 from 53.3% in 2017 as a result of an increase in both direct cremations and cremations with service.

**Funeral Operating Profit**

Consolidated funeral operating profit increased \$4.2 million, or 1.5%, in the nine months ended September 30, 2018 compared to the same period in 2017. This increase is primarily attributable to an increase in comparable funeral operating profit of \$1.2 million, or 0.4%, and the increase in revenue described above. Comparable funeral operating profit increased \$1.2 million to \$278.3 million. The change was partially due to the increased revenue described above and a \$5.2 million net benefit of deferring selling compensation under the new revenue recognition accounting standard offset by investments in selling costs associated with marketing and sales lead procurement that we believe are benefiting funeral preneed sales production, as well as expected wage increases for critical customer-facing employees.

**Cemetery Results**

	Nine Months Ended September 30,	
	2018	2017
	(In millions)	
Consolidated cemetery revenue	\$ 935.4	\$ 887.1
Less: Revenue associated with acquisitions	11.3	2.8
Less: Revenue associated with divestitures	0.6	1.5
Comparable <sup>(1)</sup> cemetery revenue	<u>\$ 923.5</u>	<u>\$ 882.8</u>
Consolidated cemetery operating profit	\$ 271.0	\$ 235.7
Less: Operating profit associated with acquisitions	2.6	0.6
Less: Operating profit (loss) associated with divestitures	0.2	(0.3)
Comparable cemetery operating profit	<u>\$ 268.2</u>	<u>\$ 235.4</u>

(1) We define comparable (or same store) operations as those cemetery locations owned by us for the entire period beginning January 1, 2017 and ending September 30, 2018.

*Cemetery Revenue*

Consolidated revenue from our cemetery operations increased \$48.3 million, or 5.4%, in the nine months ended September 30, 2018 compared to the same period in 2017, primarily attributable to a \$40.7 million increase in comparable revenue and \$8.5 million in revenue contributed by acquired properties, partially offset by the loss of \$0.9 million in properties that have been subsequently divested. The increase in comparable revenue over the prior year is primarily due to an increase in sales production, the completion of cemetery property construction projects that were previously sold, and higher other revenue (primarily endowment care trust fund income).

*Cemetery Operating Profit*

Consolidated cemetery operating profit increased \$35.3 million, or 15.0%, in the nine months ended September 30, 2018 compared to the same period in 2017. This increase is primarily the result of a \$32.8 million increase in comparable operating profit. Comparable cemetery operating profit increased \$32.8 million to \$268.2 million and the operating margin percentage increased 230 basis points to 29.0%. The improvement was partially due to the increased revenue described above and a \$8.2 million net benefit of deferring selling compensation under the new revenue recognition accounting standard partially offset by investments in digital marketing mentioned above, as well as higher labor costs due to permanent wage increases for certain of our critical customer-facing employees.

**Other Financial Statement Items**

*General and Administrative Expenses*

General and administrative expenses decreased \$14.7 million to \$107.0 million in the nine months ended September 30, 2018. The prior year period includes \$12.8 million related to a pension termination settlement and \$11.5 million related to a legal settlement. Excluding these costs, general and administrative expenses increased \$9.6 million primarily related to increases to a Company long-term incentive compensation program, which is tied to total shareholder return.

*Gains (Losses) on Divestitures and Impairment Charges, Net*

Gains on divestitures and impairment charges, net, improved \$9.8 million in the nine months ended September 30, 2018 compared to the same period of 2017, associated with the divestitures of non-strategic funeral and cemetery locations in the United States and Canada.

*Hurricane Expenses, Net*

Hurricane expenses, net, reflect \$4.9 million in damages incurred through September 30, 2018 at various locations caused by the 2018 and 2017 hurricanes, offset by \$4.5 million of insurance proceeds recognized through September 30, 2018.

Hurricane expenses, net, reflects \$1.3 million in expenses incurred in the nine months ended September 30, 2017 as we experienced repairs at various locations caused by the 2017 hurricanes.

*Interest Expense*

Interest expense increased \$9.0 million to \$134.5 million in the nine months ended September 30, 2018 as we were impacted by increased interest rates on our floating rate debt as well as an increase in the overall balance of our total debt.

*Loss on Early Extinguishment of Debt*

We incurred a \$10.1 million loss on early extinguishment of debt in the first nine months of 2018 to manage our near-term debt maturity profile and lower our effective interest rate by refinancing our 2018 notes.



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### *(Provision for) Benefit from Income Taxes*

Income tax expense during interim periods is based on our estimated annual effective income tax rate plus any discrete items, which are recorded in the period in which they occur. Discrete items include, among others, such events as changes in estimates due to the finalization of tax returns, tax audit settlements, expiration of statutes of limitation, and increases or decreases in valuation allowances on deferred tax assets. Our effective tax rate was an expense of 19.4% and a benefit of 12.3% for the nine months ended September 30, 2018 and 2017, respectively. The higher effective tax rate for the nine months ended September 30, 2018 was primarily due to the effects of the 2017 IRS audit settlement, partially offset by the decrease in the U.S. federal income tax rate and remeasurement of deferred taxes as a result of the change in estimate in the finalization of the 2017 tax return and tax reform.

### *Weighted Average Shares*

The diluted weighted average number of shares outstanding was 187.5 million in the first nine months of 2018, compared to 192.4 million in the same period in 2017. The decrease in the number of shares reflects the impact of shares repurchased under our share repurchase program.

### **Critical Accounting Policies**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the unaudited condensed consolidated financial statements and accompanying notes. Although we base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances, actual results may differ from the estimates on which our financial statements are prepared at any given point of time. Changes in these estimates could materially affect our consolidated financial position, consolidated results of operations, or cash flows. Significant items that are subject to such estimates and assumptions include revenue and expense accruals, fair value of merchandise and perpetual care trust assets, and the allocation of purchase price to the fair value of assets acquired. Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017.

There were no significant changes to our accounting policies that have occurred subsequent to December 31, 2017, except as described below within *Recent Accounting Pronouncements and Accounting Changes*.

### **Recent Accounting Pronouncements and Accounting Changes**

For discussion of recent accounting pronouncements and accounting changes, see Part I, Item 1. Financial Statements, Note 2.

### **Cautionary Statement on Forward-Looking Statements**

The statements in this 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 convey 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 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:

- Our affiliated funeral and cemetery trust funds own investments in securities, which are affected by market conditions that are beyond our control.
- We may be required to replenish our affiliated funeral and cemetery trust funds to meet minimum funding requirements, which would have a negative effect on our earnings and cash flow.
- Our ability to execute our strategic plan depends on many factors, some of which are beyond our control.
- Our credit agreements contain covenants that may prevent us from engaging in certain transactions.
- If we lost the ability to use surety bonding to support our preneed funeral and preneed cemetery activities, we may be required to make material cash payments to fund certain trust funds.
- The funeral and cemetery industry is competitive.
- Increasing death benefits related to preneed contracts funded through life insurance or annuity contracts may not cover future increases in the cost of providing a price-guaranteed service.
- The financial condition of third-party insurance companies that fund our preneed contracts may impact our future revenue.
- Unfavorable results of litigation could have a material adverse impact on our financial statements.

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- Unfavorable publicity could affect our reputation and business.
- If the number of deaths in our markets decline, our cash flows and revenue may decrease.
- If we are not able to respond effectively to changing consumer preferences, our market share, revenue, cash flows, and/or profitability could decrease.
- The continuing upward trend in the number of cremations performed in North America could result in lower revenue, operating profit, and cash flows.
- Our funeral home and cemetery businesses are high fixed-cost businesses.
- Regulation and compliance could have a material adverse impact on our financial results.
- Cemetery burial practice claims could have a material adverse impact on our financial results.
- We use a combination of insurance, self-insurance, and large deductibles in managing our exposure to certain inherent risks, therefore, we could be exposed to unexpected costs that could negatively affect our financial performance.
- A number of years may elapse before particular tax matters, for which we have established accruals, are audited and finally resolved.
- Changes in taxation as well as the inherent difficulty in quantifying potential tax effects of business decisions could have a material adverse effect on the results of our operations, financial condition, or cash flows.
- Declines in overall economic conditions beyond our control could reduce future potential earnings and cash flows and could result in future impairments to goodwill and/or other intangible assets.
- Any failure to maintain the security of the information relating to our customers, their loved ones, our associates, and our vendors could damage our reputation, could cause us to incur substantial additional costs and to become subject to litigation, and could adversely affect our operating results, financial condition, or cash flow.
- Our Canadian business exposes us to operational, economic, and currency risks.
- Our level of indebtedness could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry, and may prevent us from fulfilling our obligations under our indebtedness.
- A failure of key information technology systems or processes could disrupt and adversely affect our business.
- Failure to maintain effective internal control over financial reporting could adversely affect our results of operations, investor confidence, and our stock price.
- The application of unclaimed property laws by certain states to our preneed funeral and cemetery backlog could have a material adverse impact on our liquidity, cash flows, and our financial results.

For further information on these and other risks and uncertainties, see our Securities and Exchange Commission filings, including our 2017 Annual Report on Form 10-K. Copies of this document as well as other SEC filings can be obtained from our website at [www.sci-corp.com](http://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**

The primary objective of the following information is to provide forward-looking quantitative and qualitative information about our potential exposure to market risks. The term “market” risk refers to the risk of gains or losses arising from changes in interest rates and prices of marketable securities. The disclosures are not meant to be precise indicators of expected future gains or losses, but rather indicators of reasonably possible gains or losses. This forward-looking information provides indicators of how we view and manage our ongoing market risk exposures. All of our market risk-sensitive instruments were entered into for purposes other than trading.

#### **Marketable Equity and Debt Securities — Price Risk**

In connection with our preneed operations and sales, the related trust funds own investments in equity and debt securities and mutual funds, which are sensitive to current market prices. Cost and market values as of September 30, 2018 are presented in Part I, Item 1. Financial Statements and Note 3 of this Form 10-Q. Also, see Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations, *Financial Conditions, Liquidity and Capital Resources*, for discussion of trust investments.

### **Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**

As of September 30, 2018, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)). Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the Securities and Exchange Commission (SEC) reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time period specified by the SEC's rules and forms and that such information is accumulated and communicated to management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. Based on our evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are effective as of September 30, 2018 and that the unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial condition, results of operations, and cash flows for the periods presented in conformity with US GAAP.

**Changes in Internal Control Over Financial Reporting**

No changes in our internal control over financial reporting occurred during the quarter ended September 30, 2018 that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

Information regarding legal proceedings is set forth in Note 9 in Item 1 of Part I of this Form 10-Q, which information is hereby incorporated by reference herein.

**Item 1A. Risk Factors**

There have been no material changes in our Risk Factors as set forth in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table summarizes our share repurchases during the three months ended September 30, 2018:

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced programs	Dollar value of shares that may yet be purchased under the program
July 1, 2018 - July 31, 2018	882,515	\$ 37.04	882,515	\$ 208,606,211
August 1, 2018 - August 31, 2018	317,550	\$ 40.02	317,550	\$ 195,898,283
September 1, 2018 - September 30, 2018	35,199	\$ 41.67	35,199	\$ 194,431,422
	1,235,264		1,235,264	

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

None.

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**Item 6. Exhibits**

- [12.1](#) — [Ratio of Earnings to Fixed Charges for the three and nine months ended September 30, 2018 and 2017.](#)
- [31.1](#) — [Certification of Thomas L. Ryan as Principal Executive Officer in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- [31.2](#) — [Certification of Eric D. Tanzberger as Principal Financial Officer in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- [32.1](#) — [Certification of Periodic Financial Reports by Thomas L. Ryan as Principal Executive Officer in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- [32.2](#) — [Certification of Periodic Financial Reports by Eric D. Tanzberger as Principal Financial Officer in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 101 — Interactive data file.

**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 30, 2018

SERVICE CORPORATION INTERNATIONAL

By: /s/ Tammy Moore

Tammy Moore

Vice President and Corporate Controller  
(Principal Accounting Officer)

**SERVICE CORPORATION INTERNATIONAL  
RATIO OF EARNINGS TO FIXED CHARGES**

(In thousands, except ratio amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Earnings:				
Pretax income	\$ 86,036	66,578	\$ 315,720	\$ 266,622
Add fixed charges as adjusted (from below)	48,301	45,408	140,037	132,162
	<u>\$ 134,337</u>	<u>\$ 111,986</u>	<u>\$ 455,757</u>	<u>\$ 398,784</u>
Fixed charges:				
Interest expense:				
Corporate	\$ 44,905	\$ 41,291	\$ 129,983	\$ 121,129
Amortization of deferred financing costs	1,514	1,463	4,531	4,344
Portion of rent representative of interest	1,882	2,654	5,523	6,689
Fixed charges	<u>\$ 48,301</u>	<u>\$ 45,408</u>	<u>\$ 140,037</u>	<u>\$ 132,162</u>
Ratio (earnings divided by fixed charges)	2.78	2.47	3.25	3.02

Service Corporation International  
a Texas corporation  
CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
Section 302 Certification

I, Thomas L. Ryan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Service Corporation International, a Texas corporation (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize, and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: October 30, 2018

/s/ Thomas L. Ryan

Thomas L. Ryan  
Chairman of the Board and Chief Executive Officer  
(Principal Executive Officer)

Service Corporation International  
a Texas corporation  
CERTIFICATION OF CHIEF FINANCIAL OFFICER  
Section 302 Certification

I, Eric D. Tanzberger, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Service Corporation International, a Texas corporation (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize, and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: October 30, 2018

/s/ Eric D. Tanzberger

Eric D. Tanzberger  
Chief Financial Officer  
(Principal Financial Officer)

Certification of Chief Executive Officer

I, Thomas L. Ryan, of Service Corporation International, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2018 (the "Periodic Report") which this statement accompanies fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of Service Corporation International.

Dated: October 30, 2018

/s/ Thomas L. Ryan

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Thomas L. Ryan  
Chairman of the Board and Chief Executive Officer  
(Principal Executive Officer)



Certification of Chief Financial Officer

I, Eric D. Tanzberger, of Service Corporation International, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2018 (the "Periodic Report") which this statement accompanies fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of Service Corporation International.

Dated: October 30, 2018

/s/ Eric D. Tanzberger

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Eric D. Tanzberger  
Chief Financial Officer  
(Principal Financial Officer)

