SERVICE CORP INTERNATIONAL
Form 10-Q
July 27, 2017
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

or

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

For the transition period from __________ to __________

Commission file number 1-6402-1

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

Texas	74-1488375
(State or other jurisdiction of incorporation or organization)	(I. R. S. employer identification number)
1929 Allen Parkway, Houston, Texas	77019
(Address of principal executive offices)	(Zip code)

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

None
(Former name, former address, or former fiscal year, if changed since last report)

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

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

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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company o	Emerging growth company o

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. o

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

The number of shares outstanding of the registrant's common stock as of July 25, 2017 was 187,230,518 (net of treasury shares).

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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.

Burial Vault — 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 outer burial containers.

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 Perpetual Care or Endowment Care Fund (ECF) — A trust fund established for the purpose of maintaining cemetery grounds and property into perpetuity, also referred to as a cemetery perpetual care trust. For these trusts, the corpus remains in the trust in perpetuity and the net ordinary investment earnings are distributed to us 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.

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 Revenue — Recognized sales of interment rights in cemetery property when a minimum of 10% of the sales price has been collected and the property has been constructed and is available for interment.

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

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 inventory types 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, burial vaults, urns and other cremation receptacles, casket and cremation memorialization products, and 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 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, in mausoleums, in niches, or in cremation memorialization property.

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.

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

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Mausoleum — An above ground structure that is designed to house caskets and 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 Preneed Trust.
Preneed — Purchase of cemetery property interment rights and 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 or atneed cemetery contracts. These sales are recorded in Deferred preneed cemetery revenue until the merchandise is delivered, the service is performed, or when a minimum of 10% of the sales price has been collected 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 preneed funeral revenue 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.
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.
As used herein, each reference to the SCI Annual Report on Form 10-K for the year ended December 31, 2016 shall mean such Form 10-K as amended by the SCI Annual Report on Form 10-K/A for the year ended December 31, 2016.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In thousands, except per share amounts)			
Revenue	$773,242	$751,396	$1,550,952	$1,500,615
Costs and expenses	(589,797)	(589,407)	(1,190,342)	(1,175,703)
Operating profit	183,445	161,989	360,610	324,912
General and administrative expenses	(40,590)	(36,849)	(83,094)	(75,753)
Gains (losses) on divestitures and impairment charges, net	753	(30,641)	5,688	(30,988)
Operating income	143,608	94,499	283,204	218,171
Interest expense	(42,083)	(39,398)	(82,719)	(82,480)
Loss on early extinguishment of debt	—	(21,898)	—	(22,479)
Other expense, net	(7)	(564)	(441)	(806)
Income before income taxes	101,518	32,639	200,044	112,406
(Provision for) benefit from income taxes	(32,956)	(16,746)	43,267	(49,059)
Net income	68,562	15,893	243,311	63,347
Net income attributable to noncontrolling interests	(81)	(273)	(128)	(282)
Net income attributable to common stockholders	$68,481	$15,620	$243,183	$63,065
Basic earnings per share:				
Net income attributable to common stockholders	$0.37	$0.08	$1.29	$0.32
Basic weighted average number of shares	187,597	193,806	187,927	194,366
Diluted earnings per share:				
Net income attributable to common stockholders	$0.36	$0.08	$1.26	$0.32
Diluted weighted average number of shares	192,138	196,718	192,511	197,463
Dividends declared per share	$0.15	$0.13	$0.28	$0.25

(See notes to unaudited condensed consolidated financial statements)

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
	(In thousands)			
Net income	$68,562	$15,893	$243,311	$63,347
Other comprehensive income:				
Foreign currency translation adjustments	10,441	418	13,605	23,134
Total comprehensive income	79,003	16,311	256,916	86,481
Total comprehensive income attributable to noncontrolling interests	(88)	(273)	(135)	(291)
Total comprehensive income attributable to common stockholders	$78,915	$16,038	$256,781	$86,190

(See notes to unaudited condensed consolidated financial statements)

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SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED BALANCE SHEET
(UNAUDITED)

	June 30, 2017	December 31, 2016
	(In thousands, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$224,889	$194,986
Receivables, net	72,251	98,455
Inventories	27,333	26,431
Other	30,396	34,524
Total current assets	354,869	354,396
Preneed receivables, net and trust investments	4,572,522	4,305,165
Cemetery property	1,784,585	1,776,935
Property and equipment, net	1,828,532	1,827,587
Goodwill	1,804,493	1,799,081
Deferred charges and other assets	577,720	567,520
Cemetery perpetual care trust investments	1,465,563	1,407,465
Total assets	$12,388,284	$12,038,149
LIABILITIES & EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$441,396	$439,936
Current maturities of long-term debt	70,725	89,974
Income taxes payable	12,228	7,960
Total current liabilities	524,349	537,870
Long-term debt	3,290,944	3,196,616
Deferred revenue	1,777,828	1,731,417
Deferred tax liability	442,528	454,638
Other liabilities	372,790	510,322
Deferred preneed receipts held in trust	3,308,548	3,103,796
Care trusts' corpus	1,466,313	1,408,243
Commitments and contingencies (Note 9)		
Equity:		
Common stock, $1 per share par value, 500,000,000 shares authorized, 197,283,056 and 195,403,644 shares issued, respectively, and 187,315,112 and 189,405,244 shares outstanding, respectively	187,315	189,405
Capital in excess of par value	958,434	990,203
Retained earnings (accumulated deficit)	28,858	(103,387)
Accumulated other comprehensive income	30,090	16,492
Total common stockholders' equity	1,204,697	1,092,713
Noncontrolling interests	287	2,534
Total equity	1,204,984	1,095,247
Total liabilities and equity	$12,388,284	$12,038,149

(See notes to unaudited condensed consolidated financial statements)

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

	Six Months Ended June 30,	
	2017	2016
	(In thousands)	
Cash flows from operating activities:		
Net income	$243,311	$63,347
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on early extinguishment of debt	—	22,479
Premiums paid on early extinguishment of debt	—	(20,500)
Depreciation and amortization	75,455	72,522
Amortization of intangibles	14,051	15,392
Amortization of cemetery property	30,596	27,837
Amortization of loan costs	2,881	3,004
Provision for doubtful accounts	4,544	1,854
Benefit from deferred income taxes	(153,112)	(2,856)
(Gains) losses on divestitures and impairment charges, net	(5,688)	30,988
Share-based compensation	7,645	6,574
Excess tax benefits from share-based awards	—	(4,269)
Change in assets and liabilities, net of effects from acquisitions and divestitures:		
Decrease in receivables	20,441	10,201
Increase in other assets	(6,081)	(1,572)
Increase (decrease) in payables and other liabilities	14,815	(1,169)
Effect of preneed sales production and maturities:		
Increase in preneed receivables, net and trust investments	(64,860)	(45,511)
Increase in deferred revenue	36,345	50,916
Increase (decrease) in deferred receipts held in trust	3,880	(3,709)
Net cash provided by operating activities	224,223	225,528
Cash flows from investing activities:		
Capital expenditures	(85,324)	(83,189)
Acquisitions	(24,044)	(52,844)
Proceeds from divestitures and sales of property and equipment	7,431	11,422
Net withdrawals of restricted funds and other	175	5,120
Net cash used in investing activities	(101,762)	(119,491)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	110,000	960,000
Debt issuance costs	—	(5,232)
Payments of debt	(17,570)	(18,835)
Early extinguishment of debt	—	(875,001)
Principal payments on capital leases	(30,419)	(16,907)
Proceeds from exercise of stock options	20,601	8,872
Excess tax benefits from share-based awards	—	4,269
Purchase of Company common stock	(120,064)	(81,477)
Payments of dividends	(52,529)	(48,506)
Purchase of noncontrolling interest	(4,580)	(42)
Bank overdrafts and other	(2,065)	(1,424)

Net cash used in financing activities	(96,626)	(74,283)
Effect of foreign currency on cash and cash equivalents	4,068	5,435
Net increase in cash and cash equivalents	29,903	37,189
Cash and cash equivalents at beginning of period	194,986	134,599
Cash and cash equivalents at end of period	$224,889	$171,788

(See notes to unaudited condensed consolidated financial statements)

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

	Common Stock	Treasury Stock	Capital in Excess of Par Value	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total
Balance at December 31, 2016	$195,403	$(5,998)	$990,203	$(103,387)	$16,492	$2,534	$1,095,247
Comprehensive income	—	—	—	243,183	13,598	135	256,916
Dividends declared on common stock ($0.28 per share)	—	—	(37,010)	(15,519)	—	—	(52,529)
Employee share-based compensation earned	—	—	7,645	—	—	—	7,645
Stock option exercises	1,571	—	19,030	—	—	—	20,601
Restricted stock awards, net of forfeitures	207	—	(207)	—	—	—	—
Purchase of Company common stock	—	(3,970)	(20,675)	(95,419)	—	—	(120,064)
Noncontrolling interest payments	—	—	—	—	—	(60)	(60)
Noncontrolling interest purchases	—	—	(2,258)	—	—	(2,322)	(4,580)
Other	102	—	1,706	—	—	—	1,808
Balance at June 30, 2017	$197,283	$(9,968)	$958,434	$28,858	$30,090	$287	$1,204,984

(See notes to unaudited condensed consolidated financial statements)

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

1. Nature of Operations

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 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, 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, travel protection, and burial openings and closings, 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, 2016, 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. The Company has two reportable segments: Funeral and Cemetery. See Note 8 for further detail on the Company's segments.

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.

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, 2016. 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.

Accounting Standards Adopted in 2017

Stock Compensation

In March 2016, the FASB amended "Stock Compensation", modifying certain aspects of the accounting for share-based payment transactions, which requires the tax effects related to share-based payments to be recorded through the income statement, simplifies the accounting requirements for forfeitures and employers' tax withholding requirements, and modifies the presentation of certain items on the statement of cash flows. The guidance requires the tax effect related to the settlement of share-based awards be included in income tax benefit or expense in the statement of operations rather than in additional paid-in-capital. This guidance also eliminates the requirement to reclassify excess tax benefits from operating activities to financing activities within the statement of cash flows. We adopted the new guidance in the first quarter of 2017, as required, and the impact of the restricted stock deliveries and option exercises in the first six months and the second quarter of 2017 was a reduction to our provision for income taxes of $9.3 million and $2.9 million, respectively. Prior periods have not been retrospectively adjusted for adoption of this guidance. The remaining amendments to this standard, as noted above, are either

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not applicable or do not change our current accounting practices and thus do not impact our consolidated financial statements, including our consolidated statement of cash flows.

Inventory

In July 2015, the FASB amended "Inventory" to state that an entity using an inventory method other than last-in, first out ("LIFO") or the retail inventory method should measure inventory at the lower of cost or net realizable value. The new guidance clarifies that net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The new guidance was effective for us on January 1, 2017 and our adoption did not materially impact our consolidated results of operations, consolidated financial position, or cash flows.

Recently Issued Accounting Standards

Revenue Recognition

In May 2014, the FASB issued "Revenue from Contracts with Customers", which replaces most 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 to which we expect to be entitled for delivery of promised goods and services to our customers. The new standard will also result in enhanced revenue-related disclosures, including any significant judgments and changes in judgments. Additionally, the new standard requires the deferral of incremental selling costs to the period in which the related revenue is recognized. The new standard will be effective for us beginning January 1, 2018 and we intend to implement the standard with the modified retrospective approach, which recognizes the cumulative effect of application recognized on that date.

We established a cross-functional team and analyzed the impact on our contract portfolio by reviewing our revenue streams and our current policies and procedures to identify potential differences that would result from applying the requirements of the new standard to our contracts. The implementation team reports findings and progress of the project to management on a frequent basis. Through this process, we have identified appropriate changes to our processes, systems, and controls to support recognition and disclosure under the new standard.

In the first half of 2017, we made significant progress towards completing our evaluation of the potential changes from adopting the new standard on our future reporting and disclosures. We also made progress on our contract reviews and policy amendments, including progress on developing a process for the systemic application of the standard to existing undelivered performance obligations at adoption. Additionally, we began making programming changes to our point of sale system to accommodate recognition and disclosure under the new standard.

We have not fully determined the financial impact of the new standard to our consolidated results of operations, consolidated financial position, and cash flows. However, we believe 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 related goods and services are delivered to the customer. The incremental selling costs will be deferred and recognized by specific identification based on the delivery of the respective goods and services.

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 Consolidated Balance Sheet because they do not 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.

Financial Instruments

In January 2016, 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. The new guidance is effective for us on January 1, 2018, and we are still evaluating the impact of adoption on our consolidated results of operations, consolidated financial position, and cash flows.

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, the FASB amended "Leases" to increase transparency and comparability among organizations. Under the new standard, an entity will be required to recognize 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,

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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. This new standard will be effective for us on January 1, 2019. We are still evaluating the impact of adoption on our consolidated results of operations, consolidated financial position, and cash flows.

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 prepayment and extinguishment costs, contingent consideration in business combinations, proceeds from insurance claims, and premium payments on company-owned life insurance. The new guidance is effective for us on January 1, 2018, and we are still evaluating the impact of adoption on our consolidated statement of cash flows.

Goodwill

In January 2017, the FASB amended "Goodwill" to simplify the subsequent measurement of goodwill. 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.

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. The new guidance is effective for us on January 1, 2018, and we are still evaluating the impact on our consolidated results of operations, consolidated financial position, and cash flows.

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. The new guidance is effective for us on January 1, 2018 and is not expected to have an 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 June 30, 2017 and December 31, 2016 are as follows:

	June 30, 2017	December 31, 2016
	(In thousands)	
Preneed funeral receivables	$327,138	$312,556
Preneed cemetery receivables	1,091,264	1,038,592
Preneed receivables from customers	1,418,402	1,351,148
Unearned finance charge	(46,488)	(45,989)
Allowance for cancellation	(108,411)	(104,740)
Preneed receivables, net	$1,263,503	$1,200,419
Trust investments, at market	$3,857,858	$3,936,908
Cash held in trust [1]	648,003	304,055
Insurance-backed fixed income securities and other	268,721	271,248
Trust investments	4,774,582	4,512,211

Less: Cemetery perpetual care trust investments	(1,465,563)	(1,407,465)
Preneed trust investments	$ 3,309,019	$ 3,104,746
Preneed receivables, net and trust investments	$ 4,572,522	$ 4,305,165

(1) The higher cash balance at June 30, 2017 reflects the liquidation of certain trust assets for realignment within our trust structures that were reinvested subsequent to quarter end.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
	(In thousands)		(In thousands)	
Deposits	$106,771	$87,152	$191,258	$161,671
Withdrawals	$104,641	$86,168	$197,723	$170,043
Purchases of available-for-sale securities	$387,415	$349,789	$904,571	$641,471
Sales of available-for-sale securities [1]	$738,302	$336,491	$1,227,167	$601,070

(1) The higher activity in the second quarter reflects the liquidation of certain trust assets for realignment within our trust structures that were reinvested subsequent to quarter end.

The costs and values associated with trust investments recorded at fair value at June 30, 2017 and December 31, 2016 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.

	June 30, 2017				
	Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Value
			(In thousands)		
Fixed income securities:					
U.S. Treasury	2	$39,324	$26	$(10)	$39,340
Canadian government	2	81,661	327	(364)	81,624
Corporate	2	17,859	326	(3)	18,182
Residential mortgage-backed	2	426	17	(1)	442
Asset-backed	2	318	19	(7)	330
Equity securities:					
Preferred stock	2	6,716	186	(155)	6,747
Common stock:					
United States	1	1,059,056	178,940	(24,327)	1,213,669
Canada	1	29,392	11,524	(451)	40,465
Other international	1	58,284	8,454	(4,338)	62,400
Mutual funds:					
Equity	1	683,976	59,066	(15,324)	727,718
Fixed income	1	957,617	11,705	(29,715)	939,607
Other	3	4,921	3,004	(1)	7,924
Trust investments, at fair value		2,939,550	273,594	(74,696)	3,138,448
Fixed income commingled funds		529,020	12,607	(5,507)	536,120
Private equity		185,549	13,243	(15,502)	183,290
Trust investments, at net asset value		714,569	25,850	(21,009)	719,410
Trust investments, at market		$3,654,119	$299,444	$(95,705)	$3,857,858

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	December 31, 2016				
	Value Hierarchy Level	Cost	Unrealized Gains	Unrealized Losses	Value
			(In thousands)		
Fixed income securities:					
U.S. Treasury	2	$145,315	$884	$(838)	$145,361
Canadian government	2	79,141	409	(222)	79,328
Corporate	2	18,934	295	(227)	19,002
Residential mortgage-backed	2	333	1	(1)	333
Asset-backed	2	448	16	(31)	433
Equity securities:					
Preferred stock	2	2,907	83	(156)	2,834
Common stock:					
United States	1	1,107,942	151,146	(35,542)	1,223,546
Canada	1	25,708	10,030	(455)	35,283
Other international	1	83,238	4,995	(10,632)	77,601
Mutual funds:					
Equity	1	688,120	19,962	(56,857)	651,225
Fixed income	1	875,615	6,203	(46,219)	835,599
Other	3	4,712	2,468	(17)	7,163
Trust investments, at fair value		3,032,413	196,492	(151,197)	3,077,708
Fixed income commingled funds		692,434	8,524	(12,234)	688,724
Private equity		175,881	9,812	(15,217)	170,476
Trust investments, at net asset value		868,315	18,336	(27,451)	859,200
Trust investments, at market		$3,900,728	$214,828	$(178,648)	$3,936,908

As of June 30, 2017, our unfunded commitment for our private equity and other investments was $124.3 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 June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In thousands)		(In thousands)	
Fair value, beginning balance	$7,313	$7,991	$7,163	$8,162
Net unrealized gains included in Accumulated other comprehensive income(1)	660	555	810	384
Purchases	28	25	28	25
Sales	(77)	(18)	(77)	(18)
Fair value, ending balance	$7,924	$8,553	$7,924	$8,553

(1) All net unrealized gains recognized in Accumulated other comprehensive income for our trust investments are offset by a corresponding reclassification in Accumulated other comprehensive income to Deferred preneed receipts held in trust and Care trusts' corpus.

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Maturity dates of our fixed income securities range from 2017 to 2040. Maturities of fixed income securities (excluding mutual funds) at June 30, 2017 are estimated as follows:

	Fair Value (In thousands)
Due in one year or less	$ 84,885
Due in one to five years	50,412
Due in five to ten years	4,211
Thereafter	410
	$ 139,918

Recognized trust fund income (realized and unrealized) related to these trust investments was $45.2 million and $40.3 million for the three months ended June 30, 2017 and 2016, respectively. Recognized trust fund income (realized and unrealized) related to these trust investments was $83.3 million and $80.5 million for the six months ended June 30, 2017 and 2016, respectively.

We have determined that the remaining unrealized losses in our trust investments are considered temporary in nature, as the unrealized losses were due to temporary fluctuations in interest rates and equity prices. The investments are diversified across multiple industry segments using a balanced allocation strategy to minimize long-term risk. We believe that none of the securities are other-than-temporarily impaired based on our analysis of the investments. Our analysis included a review of the portfolio holdings and discussions with the individual money managers as to the sector exposures, credit ratings, and the severity and duration of the unrealized losses. Our trust investment unrealized losses, their associated values, and the duration of unrealized losses as of June 30, 2017 and December 31, 2016, respectively, are shown in the following tables:

	June 30, 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	$4,879	$(10)	$—	$—	$4,879	$(10)
Canadian government	13,702	(116)	3,576	(248)	17,278	(364)
Corporate	3,774	(3)	—	—	3,774	(3)
Residential mortgage-backed	152	(1)	—	—	152	(1)
Asset-backed	76	(7)	—	—	76	(7)
Equity securities:						
Preferred stock	1,817	(58)	523	(97)	2,340	(155)
Common stock:						
United States	237,944	(21,780)	19,785	(2,547)	257,729	(24,327)
Canada	2,175	(359)	924	(92)	3,099	(451)
Other international	6,198	(856)	9,868	(3,482)	16,066	(4,338)
Mutual funds:						
Equity	267,609	(8,139)	31,384	(7,185)	298,993	(15,324)
Fixed income	102,861	(1,578)	299,472	(28,137)	402,333	(29,715)
Other	—	—	16	(1)	16	(1)
Trust investments, at fair value	641,187	(32,907)	365,548	(41,789)	1,006,735	(74,696)
Fixed income commingled funds	248,507	(5,114)	17,589	(393)	266,096	(5,507)
Private equity	4,509	(777)	72,022	(14,725)	76,531	(15,502)

Trust investments, at net asset value	253,016	(5,891)	89,611	(15,118)	342,627	(21,009)
Total temporarily impaired securities	$894,203	$(38,798)	$455,159	$(56,907)	$1,349,362	$(95,705)

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	December 31, 2016					
	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	$41,409	$(838)	$—	$—	$41,409	$(838)
Canadian government	2,913	(31)	3,344	(191)	6,257	(222)
Corporate	2,107	(22)	6,162	(205)	8,269	(227)
Residential mortgage-backed	303	(1)	—	—	303	(1)
Asset-backed	28	(22)	156	(9)	184	(31)
Equity securities:						
Preferred stock	971	(53)	515	(103)	1,486	(156)
Common stock:						
United States	271,433	(23,168)	50,923	(12,374)	322,356	(35,542)
Canada	3,318	(383)	1,078	(72)	4,396	(455)
Other international	19,274	(4,139)	24,525	(6,493)	43,799	(10,632)
Mutual funds:						
Equity	234,714	(9,825)	276,504	(47,032)	511,218	(56,857)
Fixed income	323,917	(5,941)	425,614	(40,278)	749,531	(46,219)
Other	26	(2)	1,160	(15)	1,186	(17)
Trust investments, at fair value	900,413	(44,425)	789,981	(106,772)	1,690,394	(151,197)
Fixed income commingled funds	473,550	(11,714)	20,587	(520)	494,137	(12,234)
Private equity	22,677	(750)	73,100	(14,467)	95,777	(15,217)
Trust investments, at net asset value	496,227	(12,464)	93,687	(14,987)	589,914	(27,451)
Total temporarily impaired securities	$1,396,640	$(56,889)	$883,668	$(121,759)	$2,280,308	$(178,648)

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4. 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 32.5% and 51.3% for the three months ended June 30, 2017 and 2016, respectively. Our effective tax rate was a benefit of 21.6% and expense of 43.6% for the six months ended June 30, 2017 and 2016, respectively. The effective tax rate for the three and six months ended June 30, 2017 is lower than the federal statutory tax rate of 35% primarily due to the recent IRS tax settlement discussed below and a result of tax benefits recognized on the settlement of employee share-based awards.

Unrecognized Tax Benefits

As of June 30, 2017, the total amount of our unrecognized tax benefits was $79.5 million and the total amount of our accrued interest was $7.9 million.

We reached an agreement with the Internal Revenue Service (IRS) to resolve the issues under audit with respect to tax years 1999 through 2005. In March 2017, we received from the IRS Office of Appeals the fully executed Form 870-AD, which, subject to finalization of computations, effectively settles the issues under audit for those years. As a result of this resolution, we recognized a reduction in our unrecognized tax benefits of $143.0 million, of which $102.5 million was recognized as an income tax benefit for the matters that were effectively settled with an increase in our taxes payable of $40.5 million. In June 2017, we made $34.2 million in settlement payments and associated interest to the IRS.

We remain under audit for years 2006 and 2007 as a result of carryback claims. In addition, we are under audit by various state jurisdictions for years 2000 through 2015. 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. However, due to the uncertainty regarding the timing of completion and possible outcomes on the outstanding audits, a current estimate of the range of decrease that may occur within the next 12 months cannot be made.

5. Debt

Debt as of June 30, 2017 and December 31, 2016 was as follows:

	June 30, 2017	December 31, 2016
	(In thousands)	
7.625% Senior Notes due October 2018	$250,000	$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
Term Loan due March 2021	656,250	673,750
Bank Credit Facility due March 2021	460,000	350,000
Obligations under capital leases	189,058	208,758
Mortgage notes and other debt, maturities through 2050	3,687	3,753
Unamortized premiums, net	7,889	8,313
Unamortized debt issuance costs	(30,215)	(32,984)
Total debt	3,361,669	3,286,590
Less: Current maturities of long-term debt	(70,725)	(89,974)
Total long-term debt	$3,290,944	$3,196,616

Current maturities of debt at June 30, 2017 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 4.80% and 4.68% at June 30, 2017 and December 31, 2016, respectively. Approximately 62% and 63% of our total debt had a fixed interest rate at both June 30, 2017 and

December 31, 2016, respectively.

During the six months ended June 30, 2017 and 2016, we paid $79.9 million and $80.2 million in cash interest, respectively.

Bank Credit Agreement

As of June 30, 2017, we have $460.0 million of outstanding borrowings under our Bank Credit Facility due March 2021; $656.3 million of outstanding borrowings under our Term Loan due March 2021; and issued $34.3 million of letters of credit.

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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 June 30, 2017, we were in compliance with all of our debt covenants. We pay a quarterly fee on the unused commitment, which was 0.30% at June 30, 2017. As of June 30, 2017, we have $205.7 million in borrowing capacity under the Bank Credit Facility.

Debt Issuances and Additions

In the first six months of 2017, we drew $110.0 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 six months ended June 30, 2017, we made aggregate principal debt payments of $17.6 million, including $17.5 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 June 30, 2017 and December 31, 2016 was as follows:

	June 30, 2017	December 31, 2016
	(In thousands)	
7.625% Senior Notes due October 2018	$267,203	$ 272,353
4.5% Senior Notes due November 2020	204,000	205,000
8.0% Senior Notes due November 2021	178,500	175,500
5.375% Senior Notes due January 2022	438,298	444,614
5.375% Senior Notes due May 2024	896,920	884,000
7.5% Senior Notes due April 2027	239,286	231,590
Term Loan due March 2021	656,250	673,750
Bank Credit Facility due March 2021	460,000	350,000
Mortgage notes and other debt, maturities through 2050	3,687	3,753
Total fair value of debt instruments	$3,344,144	$ 3,240,560

The fair value of our long-term, fixed-rate loans were estimated using market prices for those loans, and therefore they are classified within Level 2 of the fair value measurements hierarchy. The Term Loan, Bank Credit Facility agreement, and the mortgage and other debt are classified within Level 3 of the fair value measurements hierarchy. The fair value of these instruments has been 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.

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7. Equity
(All shares reported in whole numbers)
Our components of Accumulated other comprehensive income are as follows:

	Foreign Currency Translation Adjustment	Unrealized Gains and Losses	Accumulated Other Comprehensive Income
		(In thousands)	
Balance at December 31, 2016	$ 16,492	$ —	$ 16,492
Activity in 2017	13,598	—	13,598
Net unrealized gains associated with available-for-sale securities of the trusts, net of taxes	—	107,499	107,499
Reclassification of net unrealized gain activity attributable to the Deferred preneed receipts held in trust and Care trusts' corpus, net of taxes	—	(107,499)	(107,499)
Balance at June 30, 2017	$ 30,090	$ —	$ 30,090
Balance at December 31, 2015	$ 6,164	$ —	$ 6,164
Activity in 2016	23,125	—	23,125
Net unrealized gains associated with available-for-sale securities of the trusts, net of taxes	—	70,208	70,208
Reclassification of net unrealized gains activity attributable to the Deferred preneed receipts held in trust and Care trusts' corpus, net of taxes	—	(70,208)	(70,208)
Balance at June 30, 2016	$ 29,289	$ —	$ 29,289

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

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 six months ended June 30, 2017, we repurchased 3,969,544 shares of common stock at an aggregate cost of $120.1 million, which is an average cost per share of $30.25. After these repurchases, the remaining dollar value of shares authorized to be purchased under our share repurchase program was approximately $248.2 million at June 30, 2017. Subsequent to June 30, 2017, we repurchased 103,599 shares of common stock at an aggregate cost of $3.5 million, which is an average cost per share of $33.45. After these subsequent repurchases, the remaining dollar value of shares authorized to be repurchased under our repurchase program is $244.7 million.

Noncontrolling Interest

In May 2017, we purchased the remaining 11% of the common stock of our consolidated subsidiary, Wilson Financial Group, Inc. for $4.6 million.

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.

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Our reportable segment information is as follows:

	Funeral	Cemetery	Reportable Segments
	(In thousands)		
Three months ended June 30,			
Revenue from external customers:			
2017	$458,874	$314,368	$773,242
2016	$467,104	$284,292	$751,396
Operating profit:			
2017	$92,077	$91,368	$183,445
2016	$89,432	$72,557	$161,989
Six Months Ended June 30,			
Revenue from external customers:			
2017	$957,638	$593,314	$1,550,952
2016	$959,293	$541,322	$1,500,615
Operating profit:			
2017	$204,684	$155,926	$360,610
2016	$196,643	$128,269	$324,912

The following table reconciles operating profit from reportable segments to our consolidated income before income taxes:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Operating profit from reportable segments	$183,445	$161,989	$360,610	$324,912
General and administrative expenses	(40,590)	(36,849)	(83,094)	(75,753)
Gains (losses) on divestitures and impairment charges, net	753	(30,641)	5,688	(30,988)
Operating income	143,608	94,499	283,204	218,171
Interest expense	(42,083)	(39,398)	(82,719)	(82,480)
Loss on early extinguishment of debt	—	(21,898)	—	(22,479)
Other expense, net	(7)	(564)	(441)	(806)
Income before income taxes	$101,518	$32,639	$200,044	$112,406

Our geographic area information is as follows:

	United States	Canada	Total
		(In thousands)	
Three months ended June 30,			
Revenue from external customers:			
2017	$728,370	$ 44,872	$773,242
2016	$707,434	$ 43,962	$751,396
Six Months Ended June 30,			
Revenue from external customers:			
2017	$1,455,610	$ 95,342	$1,550,952
2016	$1,416,322	$ 84,293	$1,500,615

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 June 30, 2017 and December 31, 2016, we have self-insurance reserves of $80.9 million and $78.0 million, respectively.

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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, and Romano lawsuits described below.

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. 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 plantiffs' claims, ruling that they did not sue the correct party. We cannot quantify our ultimate liability, if any, in this lawsuit.

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 current and former non-exempt California employees of defendants 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, attorneys' fees and costs, interest, and injunctive relief. The claims have been ordered to arbitration, with the arbitrator to determine whether the claims will proceed as a class or individual claims. 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. We cannot quantify our ultimate liability, if any, in this lawsuit.

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 an SCI subsidiary and purports to have been brought on behalf of persons who worked as independent sales representatives in California during the four years preceding the filing of the complaint. 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. We cannot quantify our ultimate liability, if any, in the lawsuit.

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. 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 filed documents indicating that they are appealing the dismissal. We cannot quantify our ultimate liability, if any, for the payment of damages.

Operational Claims. We are subject to the following lawsuit.

Linda Allard, on behalf of herself and all others similarly situated v. SCI Direct, Inc., Case No 16-1033; In the United States District Court, Middle District of Tennessee. This case was filed in June 2016 as a class action under the Telephone Consumer Protection Act (the Act). Plaintiff alleges she received telemarketing telephone calls that were made with a prerecorded voice or made by an automatic telephone dialing system in violation of the Act. Plaintiff seeks actual and statutory damages, as well as attorney’s fees and costs. In July 2017, the court denied our subsidiary's motion for summary judgment. The parties have scheduled a mediation for August 1, 2017. We cannot quantify our ultimate liability, if any, in this lawsuit.

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

We received notices from a third party auditor representing unclaimed property departments of 36 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 unclaimed funds. The auditor seeks escheatment of funds from the portion of such contracts for which it claims that we will probably not be required to provide services or merchandise in the future. No actual audits have commenced at this time. We cannot quantify our ultimate liability, if any, in this matter.

The ultimate outcome of the matters described above cannot be determined at this time. 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.

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		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
	(In thousands, except per share amounts)			
Amounts attributable to common stockholders:				
Net income:				
Net income — basic	$68,481	$15,620	$243,183	$63,065
After tax interest on convertible debt	13	10	25	22
Net income — diluted	$68,494	$15,630	$243,208	$63,087
Weighted average shares (denominator):				
Weighted average shares — basic	187,597	193,806	187,927	194,366
Stock options	4,333	2,788	4,389	2,975
Restricted stock units	87	3	74	1
Convertible debt	121	121	121	121
Weighted average shares — diluted	192,138	196,718	192,511	197,463
Net income per share:				
Basic	$0.37	$0.08	$1.29	$0.32
Diluted	$0.36	$0.08	$1.26	$0.32

The computation of diluted EPS excludes outstanding stock options and restricted stock units in certain periods in which the inclusion of such options or restricted stock units 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		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
	(In thousands)			
Antidilutive options	1,523	1,799	1,212	2,338
Antidilutive restricted stock units	—	—	—	24
Total common stock equivalents excluded from computation	1,523	1,799	1,212	2,362

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11. 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		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
	(In thousands)			
Gains on divestitures, net	$5,922	$685	$22,673	$2,111
Impairment losses	(5,169)	(31,326)	(16,985)	(33,099)
Gains (losses) on divestitures and impairment charges, net	$753	$(30,641)	$5,688	$(30,988)

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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 June 30, 2017, we operated 1,502 funeral service locations and 475 cemeteries (including 286 funeral service/cemetery combination locations), which are geographically diversified across 45 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 enables 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 $10.3 billion backlog of future revenue from both trust and insurance-funded sales at June 30, 2017, which is the result of preneed sales. Preneed selling provides us with a current opportunity to lock-in future market share while deterring the customer from going to a competitor in the future. We 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 we collect 10% from the customer and the property is developed).

We believe we have the financial strength and flexibility to reward shareholders through dividends and share repurchases while maintaining a prudent capital structure and pursuing new opportunities for profitable growth.

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 have developed memorialization merchandise and services that specifically appeal to cremation customers. We believe that these additional merchandise and services 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 $224.2 million in the first six months of 2017. We have $205.7 million in borrowing capacity under our bank credit agreement.

Our bank credit agreement requires us to maintain certain leverage and interest coverage ratios. As of June 30, 2017, we were in compliance with all of our debt covenants. Our financial covenant requirements and actual ratios as of June 30, 2017 are as follows:

	Per Credit Agreement	Actual
Leverage ratio	4.25 (Max)	3.71
Interest coverage ratio	3.00 (Min)	5.43

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 intend to 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 $0.15 per common share in 2017. We target a payout ratio of 35% to 45% 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

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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 six months ended June 30, 2017, we repurchased 3,969,544 shares of common stock at an aggregate cost of $120.1 million, which is an average cost per share of $30.25. After these repurchases, the remaining dollar value of shares authorized to be purchased under our share repurchase program was approximately $248.2 million at June 30, 2017. 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.

Subsequent to June 30, 2017, we repurchased 103,599 shares of common stock at an aggregate cost of $3.5 million, which is an average cost per share of $33.45. After these third quarter repurchases, the remaining dollar value of shares authorized to be repurchased under our repurchase program is $244.7 million.

Repurchase debt. We will seek to make 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 is 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 and investing needs.

Operating Activities

Net cash provided by operating activities decreased $1.3 million to $224.2 million in the first six months of 2017, compared to $225.5 million in the first six months of 2016. Included in 2017 are a decrease of $20.5 million in premiums paid on early extinguishment of debt, an $8.3 million decrease in system and process transition costs, and a $4.3 million decrease in excess tax benefits from share-based awards partially offset by an increase of $34.2 million cash taxes paid related to the March 2017 IRS tax settlement and a $6.3 million increase in pension settlement payments. See discussion regarding the change in accounting treatment for excess tax benefits from share-based awards and IRS tax settlements in Part I, Item 1. Financial Statements, Notes 2 and 4.

Excluding the above items, cash flow from operations increased $6.1 million as a result of the following:

- a $48.3 million increase in cash receipts from customers
- a $0.3 million decrease in cash interest paid; and
- a $3.9 million decrease in net trust deposits, partially offset by
- a $22.2 million increase in cash tax payments (excluding the March 2017 IRS tax settlement noted above);
- a $5.6 million increase in vendor and other payments;
- a $6.9 million increase in employee compensation; and
- an $11.7 million decrease in General Agency (GA) and other receipts.

Investing Activities

Cash flows from investing activities used $101.8 million in the first six months of 2017 compared to using $119.5 million in the same period of 2016. This was primarily attributable to a decrease of $28.8 million in cash spent on acquisitions, a $4.0 million decrease in cash receipts from divestitures and asset sales, a $4.9 million decrease in net withdrawals of restricted funds, and a $2.1 million increase in capital expenditures.

Financing Activities

Financing activities used $96.6 million in the first six months of 2017 compared to using $74.3 million in the same period of 2016. This increase was primarily driven by an increase in purchases of Company common stock of $38.6 million, a $4.5 million increase in purchases of noncontrolling interests to acquire the remaining 11% of the common stock of our consolidated subsidiary, Wilson Financial Group, Inc., a decrease of $4.3 million in excess tax benefits from share-based awards, and a $4.0 million increase in payments of dividends, partially offset by an increase in net

debt issuance proceeds net of payments of $18.0 million, and increased proceeds from exercises of stock options of $11.7 million.
We repurchased 4.0 million shares in the first six months of 2017 for $120.1 million and 3.3 million shares in the same period of 2016 for $81.5 million. We paid cash dividends of $52.5 million in the first six months of 2017 and $48.5 million in the same period of 2016.

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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. The breakdown of surety bonds between funeral and cemetery preneed arrangements, as well as surety bonds for other activities, is described below.

	June 30, 2017	December 31, 2016
	(In millions)	
Preneed funeral	$112.5	$ 118.6
Preneed cemetery:		
Merchandise and services	135.3	141.6
Pre-construction	10.6	7.8
Bonds supporting preneed obligations	258.4	268.0
Bonds supporting preneed business permits	4.6	4.5
Other bonds	17.3	18.4
Total surety bonds outstanding	$280.3	$ 290.9

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 six months ended June 30, 2017 and 2016, we had $11.9 million and $10.6 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. Since 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 contracts be paid into trusts and/or escrow accounts until the merchandise is delivered or the service is performed. These trust funds own investments in equity and debt securities and mutual funds, which are sensitive to current market prices. 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.

Trust-Funded Preneed Contracts: The funds are deposited into trust and invested by independent trustees in accordance with state and provincial laws. 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.

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The tables below detail our results of preneed production and maturities, excluding insurance contracts, for the three and six months ended June 30, 2017 and 2016.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In millions)		(In millions)	
Funeral:				
Preneed trust-funded (including bonded):				
Sales production	$81.1	$72.0	$164.5	$143.9
Sales production (number of contracts)	23,971	22,738	49,661	46,013
Maturities	$64.1	$57.4	$131.7	$119.1
Maturities (number of contracts)	16,646	15,823	34,832	33,122
Cemetery:				
Sales production:				
Preneed	$235.8	$222.4	$443.5	$405.8
Atneed	79.5	78.5	163.2	157.5
Total sales production	$315.3	$300.9	$606.7	$563.3
Sales production deferred to backlog:				
Preneed	$112.6	$107.8	$200.7	$189.9
Atneed	58.3	57.8	118.7	116.8
Total sales production deferred to backlog	$170.9	$165.6	$319.4	$306.7
Revenue recognized from backlog:				
Preneed	$75.7	$61.9	$130.7	$113.7
Atneed	58.3	57.8	115.6	114.8
Total revenue recognized from backlog	$134.0	$119.7	$246.3	$228.5

Insurance-Funded Preneed Contracts: Where permitted by state or provincial law, customers may arrange their preneed contract by purchasing a life insurance policy from third-party insurance companies, for which we earn a commission as a general sales agent for the insurance company. The policy amount of the insurance contract between the customer and the third-party insurance company generally equals the amount of the preneed contract. As the insurance contract is between the insurance company and the customer, we do not reflect the unfulfilled insurance-funded preneed contract amounts in our unaudited condensed Consolidated Balance Sheet.

The table below details the results of insurance-funded preneed production and maturities for the three and six months ended June 30, 2017 and 2016, and the number of contracts associated with those transactions.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In millions)		(In millions)	
Preneed insurance-funded:				
Sales production (1)	$133.0	$151.2	$261.3	$290.5
Sales production (number of contracts) (1)	21,979	24,657	43,008	47,722
General agency revenue	$30.0	$37.1	$61.8	$73.3
Maturities	$80.8	$79.5	$172.1	$163.4
Maturities (number of contracts)	13,607	13,411	29,083	27,835

(1) Amounts are not included in our unaudited condensed Consolidated Balance Sheet.

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 June 30, 2017 and December 31, 2016. Additionally, the table reflects our backlog of unfulfilled insurance-funded contracts (which are not included in our unaudited condensed Consolidated Balance Sheet) at June 30, 2017 and December 31, 2016. The backlog amounts presented are reduced by an amount that we believe will cancel before maturity based on historical experience. The table does not include the backlog associated with businesses that are held for sale.

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The table also reflects our preneed receivables and trust investments (fair value and cost bases) associated with the backlog of deferred preneed contract revenue, net of the estimated cancellation allowance. 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 assets associated with this revenue. Becau