

SERVICE CORPORATION INTERNATIONAL
Form 10-Q
October 24, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013

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

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

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

(Do not check if smaller reporting
company)

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

The number of shares outstanding of the registrant's common stock as of October 22, 2013 was 211,960,401 (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 and cemetery arrangements sold after a death has occurred.

Burial Vaults — A reinforced container intended to inhibit the subsidence of the earth and house the casket after it is placed in the ground.

Cemetery Perpetual Care or Endowment Care Fund — A trust fund established for the purpose of maintaining cemetery grounds and property into perpetuity.

Cemetery Property — Developed lots, lawn crypts, and mausoleum spaces and undeveloped land we intend to develop.

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

Cemetery Merchandise and Services — Stone and bronze memorials, markers, merchandise installations, and burial openings and closings.

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

Funeral Merchandise and Services — Professional services relating to funerals and cremations and funeral-related merchandise, including caskets, casket memorialization products, burial vaults, cremation receptacles, cremation memorial products, and flowers.

Funeral Recognized Preneed Revenue — Funeral merchandise and products sold on a preneed contract and delivered before a death has occurred, including funeral merchandise and travel protection insurance, which primarily represents sales by the Neptune Society.

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

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

Interment — The burial or final placement of human remains in the ground, in mausoleums, or in cremation niches.

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

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

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

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

Preneed — Purchase of products and services prior to a death occurring.

Preneed Backlog — Future revenues from unfulfilled preneed funeral and cemetery contractual arrangements.

Preneed Cemetery Production — Sales of preneed or atneed cemetery contracts. These earnings are recorded in Deferred preneed cemetery revenues until the service is performed or the merchandise is delivered.

Preneed Funeral Production — Sales of preneed funeral trust-funded and insurance-funded contracts. Preneed funeral trust-funded contracts are recorded in Deferred preneed funeral revenues until the service is performed or the merchandise is delivered. We do not reflect the unfulfilled insurance-funded preneed funeral contract amounts in our consolidated balance sheet. The proceeds of the life insurance policies or annuity contracts will be reflected in funeral revenues as these funerals are performed by the Company.

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

Trust Fund Income — Recognized 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.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|------------|------------------------------------|--------------|
| | 2013 | 2012 | 2013 | 2012 |
| | (In thousands, except per share amounts) | | | |
| Revenues | \$609,951 | \$581,182 | \$1,887,808 | \$1,781,060 |
| Costs and expenses | (493,872) | (459,911) | (1,486,308) | (1,404,033) |
| Gross profits | 116,079 | 121,271 | 401,500 | 377,027 |
| General and administrative expenses | (33,764) | (26,410) | (95,792) | (81,927) |
| Gains (losses) on divestitures and impairment charges, net | 981 | 315 | (5,533) | 883 |
| Operating income | 83,296 | 95,176 | 300,175 | 295,983 |
| Interest expense | (38,080) | (33,568) | (103,589) | (101,050) |
| Gains on early extinguishment of debt, net | — | — | 468 | — |
| Other income (expense), net | 666 | 2,317 | (1,017) | 4,001 |
| Income before income taxes | 45,882 | 63,925 | 196,037 | 198,934 |
| Provision for income taxes | (18,488) | (22,128) | (75,485) | (71,183) |
| Net income | 27,394 | 41,797 | 120,552 | 127,751 |
| Net income attributable to noncontrolling interests | (615) | (735) | (2,537) | (1,588) |
| Net income attributable to common stockholders | \$26,779 | \$41,062 | \$118,015 | \$126,163 |
| Basic earnings per share: | | | | |
| Net income attributable to common stockholders | \$0.13 | \$0.19 | \$0.56 | \$0.58 |
| Basic weighted average number of shares | 211,954 | 214,914 | 211,721 | 216,974 |
| Diluted earnings per share: | | | | |
| Net income attributable to common stockholders | \$0.12 | \$0.19 | \$0.55 | \$0.57 |
| Diluted weighted average number of shares | 216,370 | 218,460 | 215,877 | 220,306 |
| Dividends declared per share | \$0.07 | \$0.06 | \$0.20 | \$0.17 |

(See notes to unaudited condensed consolidated financial statements)

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CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------|------------------------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| | (In thousands) | | (In thousands) | |
| Net income | \$27,394 | \$41,797 | \$120,552 | \$127,751 |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustments | 7,497 | 13,513 | (9,773) | 10,991 |
| Total comprehensive income | 34,891 | 55,310 | 110,779 | 138,742 |
| Total comprehensive income attributable to noncontrolling interests | (620) | (745) | (2,532) | (1,600) |
| Total comprehensive income attributable to common stockholders | \$34,271 | \$54,565 | \$108,247 | \$137,142 |

(See notes to unaudited condensed consolidated financial statements)

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SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED BALANCE SHEET
(UNAUDITED)

| | September 30, 2013 | December 31, 2012 |
|---|--------------------------------------|----------------------|
| | (In thousands, except share amounts) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 182,592 | \$ 92,708 |
| Receivables, net | 78,990 | 101,817 |
| Deferred tax assets | 42,813 | 42,864 |
| Inventories, net | 24,612 | 24,560 |
| Other | 28,963 | 20,546 |
| Total current assets | 357,970 | 282,495 |
| Preneed funeral receivables, net and trust investments | 1,577,398 | 1,535,932 |
| Preneed cemetery receivables, net and trust investments | 2,003,478 | 1,826,835 |
| Cemetery property, at cost | 1,486,095 | 1,489,948 |
| Property and equipment, net | 1,623,187 | 1,641,101 |
| Goodwill, net | 1,377,946 | 1,382,410 |
| Restricted Cash | 419,548 | 4,457 |
| Deferred charges and other assets | 423,014 | 420,810 |
| Cemetery perpetual care trust investments | 1,120,726 | 1,099,580 |
| Total assets | \$ 10,389,362 | \$ 9,683,568 |
| LIABILITIES & EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$ 392,011 | \$ 373,783 |
| Current maturities of long-term debt | 36,647 | 31,429 |
| Income taxes | 3,103 | 6,892 |
| Total current liabilities | 431,761 | 412,104 |
| Long-term debt | 2,257,103 | 1,916,621 |
| Deferred preneed funeral revenues | 523,091 | 536,647 |
| Deferred preneed cemetery revenues | 895,893 | 861,148 |
| Deferred tax liability | 530,670 | 471,198 |
| Other liabilities | 397,113 | 399,950 |
| Deferred preneed funeral and cemetery receipts held in trust | 2,793,456 | 2,624,321 |
| Care trusts' corpus | 1,119,501 | 1,098,752 |
| Commitments and contingencies (Note 15) | | |
| Equity: | | |
| Common stock, \$1 per share par value, 500,000,000 shares authorized, 212,082,348 and 211,056,501 shares issued, respectively, and 211,960,401 and 211,046,501 shares outstanding, respectively | 211,960 | 211,047 |
| Capital in excess of par value | 1,282,667 | 1,307,058 |
| Accumulated deficit | (169,797 |) (286,795 |
| Accumulated other comprehensive income | 101,949 | 111,717 |
| Total common stockholders' equity | 1,426,779 | 1,343,027 |
| Noncontrolling interests | 13,995 | 19,800 |
| Total equity | 1,440,774 | 1,362,827 |
| Total liabilities and equity | \$ 10,389,362 | \$ 9,683,568 |

(See notes to unaudited condensed consolidated financial statements)

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

| | Nine Months Ended September 30, | |
|--|------------------------------------|------------|
| | 2013 | 2012 |
| | (In thousands) | |
| Cash flows from operating activities: | | |
| Net income | \$ 120,552 | \$ 127,751 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Gains on early extinguishment of debt, net | (468 |) — |
| Depreciation and amortization | 91,945 | 89,349 |
| Amortization of intangible assets | 16,619 | 17,950 |
| Amortization of cemetery property | 32,036 | 31,528 |
| Amortization of loan costs | 3,997 | 3,635 |
| Provision for doubtful accounts | 5,238 | 6,801 |
| Provision for deferred income taxes | 55,784 | 57,428 |
| Losses (gains) on divestitures and impairment charges, net | 5,533 | (883 |
| Share-based compensation | 8,887 | 8,217 |
| Excess tax benefits from share based awards | (6,083 |) — |
| Change in assets and liabilities, net of effects from acquisitions and divestitures: | | |
| Decrease in receivables | 14,487 | 1,066 |
| Increase in other assets | (14,636 |) (6,331 |
| Increase in payables and other liabilities | 24,767 | 6,623 |
| Effect of preneed funeral production and maturities: | | |
| Decrease in preneed funeral receivables, net and trust investments | 33,066 | 34,134 |
| Decrease in deferred preneed funeral revenue | (10,202 |) (30,325 |
| Decrease in deferred preneed funeral receipts held in trust | (34,026 |) (18,185 |
| Effect of cemetery production and deliveries: | | |
| Increase in preneed cemetery receivables, net and trust investments | (49,500 |) (72,012 |
| Increase in deferred preneed cemetery revenue | 36,183 | 27,502 |
| Decrease in deferred preneed cemetery receipts held in trust | (8,051 |) (480 |
| Other | 306 | (3,481 |
| Net cash provided by operating activities | 326,434 | 280,287 |
| Cash flows from investing activities: | | |
| Capital expenditures | (79,586 |) (80,973 |
| Acquisitions | (8,543 |) (19,281 |
| Proceeds from divestitures and sales of property and equipment, net | 10,013 | 8,933 |
| Net withdrawals (deposits) of restricted funds | 341 | (3,816 |
| Net cash used in investing activities | (77,775 |) (95,137 |
| Cash flows from financing activities: | | |
| Proceeds from issuance of long-term debt | — | 17,907 |
| Payments of debt | (91,794 |) (988 |
| Principal payments on capital leases | (19,585 |) (19,303 |
| Proceeds from exercise of stock options | 4,954 | 17,347 |
| Excess tax benefits from share based awards | 6,083 | — |
| Purchase of Company common stock | (1,708 |) (144,607 |
| Payments of dividends | (42,371 |) (34,844 |

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| | | | |
|---|-----------|---|------------|
| Purchase of noncontrolling interest | (8,333 |) | — |
| Bank overdrafts and other | (5,479 |) | 868 |
| Net cash used in financing activities | (158,233 |) | (163,620) |
| Effect of foreign currency on cash and cash equivalents | (542 |) | 1,448 |
| Net increase in cash and cash equivalents | 89,884 | | 22,978 |
| Cash and cash equivalents at beginning of period | 92,708 | | 128,569 |
| Cash and cash equivalents at end of period | \$182,592 | | \$151,547 |

(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 | Accumulated Deficit | Accumulated Other Comprehensive Income | Noncontrolling Interests | Total |
|--|-----------------|-------------------|--------------------------------------|------------------------|---|-----------------------------|--------------|
| Balance at December 31, 2011 | \$ 224,666 | \$(1,710) | \$ 1,430,330 | \$(367,044) | \$ 105,852 | \$ 20,101 | \$ 1,412,195 |
| Comprehensive income | — | — | — | 126,163 | 10,979 | 1,600 | 138,742 |
| Dividends declared on common stock (\$.17 per share) | — | — | (36,582) | — | — | — | (36,582) |
| Employee share-based compensation earned | — | — | 8,217 | — | — | — | 8,217 |
| Stock option exercises | 2,853 | — | 14,494 | — | — | — | 17,347 |
| Restricted stock awards, net of forfeitures | 483 | — | (483) | — | — | — | — |
| Purchase of Company common stock | — | (12,400) | (79,828) | (52,379) | — | — | (144,607) |
| Noncontrolling interest payment | — | — | — | — | — | (405) | (405) |
| Other | 82 | — | 866 | — | — | — | 948 |
| Balance at September 30, 2012 | \$ 228,084 | \$(14,110) | \$ 1,337,014 | \$(293,260) | \$ 116,831 | \$ 21,296 | \$ 1,395,855 |
| Balance at December 31, 2012 | 211,057 | (10) | 1,307,058 | (286,795) | 111,717 | 19,800 | 1,362,827 |
| Comprehensive income | — | — | — | 118,015 | (9,768) | 2,532 | 110,779 |
| Dividends declared on common stock (\$.20 per share) | — | — | (42,371) | — | — | — | (42,371) |
| Employee share-based compensation earned | — | — | 8,887 | — | — | — | 8,887 |
| Stock option exercises | 573 | — | 4,524 | — | — | — | 5,097 |
| Restricted stock awards, net of forfeitures | 378 | (3) | (375) | — | — | — | — |
| Purchase of Company common stock | — | (117) | (717) | (1,017) | — | — | (1,851) |
| Cancellation of Company Stock | (8) | 8 | — | — | — | — | — |
| Tax Benefits Related to Share-Based Awards | — | — | 6,083 | — | — | — | 6,083 |

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| | | | | | | | |
|-------------------------------------|-----------|----------|-------------|--------------|------------|-----------|-------------|
| Purchase of noncontrolling interest | — | — | (1,696) | — | — | (6,637) | (8,333) |
| Noncontrolling interest payment | — | — | — | — | — | (1,700) | (1,700) |
| Other | 82 | — | 1,274 | — | — | — | 1,356 |
| Balance at September 30, 2013 | \$212,082 | \$(122) | \$1,282,667 | \$(169,797) | \$ 101,949 | \$ 13,995 | \$1,440,774 |

(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)

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1. Nature of Operations

We are North America's largest provider of deathcare products and services, with a network of funeral service locations and cemeteries primarily operating in the United States and Canada. Our operations consist of funeral service locations, cemeteries, funeral service/cemetery combination locations, crematoria, and related businesses. Funeral service locations provide all professional services relating to funerals and cremations, including the use of funeral facilities and motor vehicles and preparation and embalming services. Funeral-related merchandise, including caskets, casket memorialization products, burial vaults, cremation receptacles, cremation memorial products, flowers, and other ancillary products and services, is sold at funeral service locations. Cemeteries provide cemetery property interment rights, including developed lots, lawn crypts, and mausoleum spaces and sell cemetery-related merchandise and services, including stone and bronze memorials, markers, merchandise installations, and burial openings and closings. We also sell preneed funeral and cemetery merchandise and services whereby a customer contractually agrees to the terms of certain products and services to be provided in the future.

On May 29, 2013, we entered into a definitive agreement to acquire all of the outstanding shares of Stewart Enterprises, Inc. (Stewart) for \$13.25 per share in cash. Stewart operates 217 funeral homes and 141 cemeteries as of July 31, 2013. The transaction provides us with an opportunity for growth consistent with our capital deployment strategy and will allow us the ability to serve a number of new, complementary areas, while enabling us to capitalize on what we believe will produce significant synergies and operating efficiencies. The transaction is valued at approximately \$1.5 billion, which includes approximately \$331.6 million of Stewart's debt. We expect to fund the transaction with cash on hand, the utilization of debt under our new credit agreement, the proceeds from the July 2013 issuance of our long-term senior notes as discussed in Note 9 and assuming \$200.0 million of Stewart's debt. The acquisition is subject to, among other conditions, antitrust clearance. It is anticipated that the acquisition will be completed by the end of 2013 or in early 2014, however there can be no assurance that the acquisition will be completed by this time or at all.

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2. Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

Our unaudited condensed consolidated financial statements include the accounts of Service Corporation International (SCI) and all subsidiaries in which we hold a controlling financial interest. Our financial statements also include the accounts of the funeral merchandise and service trusts, cemetery merchandise and service trusts, and cemetery perpetual care trusts in which we have a variable interest and are the primary beneficiary. Our interim condensed consolidated financial statements are unaudited but include all adjustments, consisting of normal recurring accruals and any other adjustments, which management considers necessary for a fair statement of our results for these periods. Our unaudited condensed consolidated financial statements have been prepared in a manner consistent with the accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2012, 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

Certain reclassifications have been made to prior amounts to conform to the current period financial statements 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, 2012. These estimates and assumptions may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. As a result, actual results could differ from these estimates.

Preneed Funeral and Cemetery Receivables

We sell preneed funeral and cemetery contracts whereby the customer enters into arrangements for future merchandise and services prior to the time of need. As these contracts are entered into prior to the delivery of the related goods and services, the preneed funeral and cemetery receivables are offset by a comparable deferred revenue amount. These receivables generally have an interest component for which interest income is recorded when the interest amount is considered collectible and realizable, which typically coincides with cash payment. We do not accrue interest on financing receivables that are not paid in accordance with the contractual payment date given the nature of our goods and services, the nature of our contracts with customers, and the timing of the delivery of our services. We do not consider receivables to be past due until the service or goods are required to be delivered at which time the preneed receivable is paid or reclassified as a trade receivable with payment terms of less than 30 days. As the preneed funeral and cemetery receivables are offset by comparable deferred revenue amounts, we have no risk of loss related to these receivables.

If a preneed contract is canceled prior to delivery, state or provincial law governs the amount of the refund owed to the customer, if any, including the amount of the attributed investment earnings. Upon cancellation, we receive the amount of principal deposited to the trust and previously undistributed net investment earnings and, where required, issue a refund to the customer. We retain excess funds, if any, and recognize the attributed investment earnings (net of any investment earnings payable to the customer) as revenue in the consolidated statement of operations. In certain jurisdictions, we may be obligated to fund any shortfall if the amount deposited by the customers exceed the funds in trust. Based on our historical experience, we have provided an allowance for cancellation of these receivables, which is recorded as a reduction in receivables with a corresponding offset to deferred revenue.

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3. Recently Issued Accounting Standards

Income Taxes

In July 2013, the Financial Accounting Standards Board (FASB) amended the Income Taxes Topic of the Accounting Standards Codification (ASC) to eliminate a diversity in practice for the presentation of unrecognized tax benefits when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendment requires that the unrecognized tax benefit be presented as a reduction of the deferred tax assets associated with the carryforwards except in certain circumstances when it would be reflected as a liability. This amendment is effective for us starting with our first quarter of 2014 and we are still evaluating the impact of adoption on our consolidated financial condition.

Foreign Currency

In March 2013, the FASB amended the Foreign Currency Matters Topic of the ASC to clarify the appropriate accounting when a parent ceases to have a controlling interest in a subsidiary or group of assets that is a business within a foreign entity. This clarification provides that the cumulative translation adjustment should only be released into net income if the loss of controlling interest represents complete or substantially complete liquidation of the foreign entity in which the subsidiary or asset group had resided. This amendment is effective for us starting with our first quarter of 2014 and adoption would impact our consolidated financial condition and results of operations if we dispose of a foreign entity.

Comprehensive Income

In February 2013, the FASB amended the Comprehensive Income Topic of the ASC to require reporting of amounts reclassified out of accumulated comprehensive income by component. We are required to present significant amounts reclassified to net income in their entirety by income statement line item and to cross reference any disclosure elsewhere in the notes for amounts reclassified in less than their entirety. We adopted this amendment effective January 1, 2013 and the appropriate disclosures are contained in Note 12.

Intangible Testing

In July 2012, the FASB amended the Intangibles - Goodwill and Other Topic of the ASC that allows us to make a qualitative assessment of whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount. If, after assessing the relevant information, we determine it is more likely than not that the fair value is more than the carrying amount, no additional analysis is necessary. If we determine it is more likely than not that the fair value is less than the carrying amount, then we are required to proceed to the quantitative approach. The amended guidance is effective for us as of our annual test in the fourth quarter of 2013, and adoption is not expected to impact our consolidated financial condition or results of operations.

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4. Preneed Funeral Activities

Preneed funeral receivables, net and trust investments represent trust investments, including investment earnings, and customer receivables, net of unearned finance charges, related to unperformed, price-guaranteed preneed funeral contracts. Our funeral merchandise and service trusts are variable interest entities as defined in the Consolidation Topic of the ASC. In accordance with this guidance, we have determined that we are the primary beneficiary of these trusts, as we absorb a majority of the losses and returns associated with these trusts. Our cemetery trust investments detailed in Notes 5 and 6 are also accounted for as variable interest entities. When we receive payments from the customer, we deposit the amount required by law into the trust and reclassify the corresponding amount from Deferred preneed funeral revenues into Deferred preneed funeral and cemetery receipts held in trust. Amounts are withdrawn from the trusts after the contract obligations are performed. Cash flows from preneed funeral contracts are presented as operating cash flows in our unaudited condensed consolidated statement of cash flows.

Preneed funeral receivables, net and trust investments are reduced by the trust investment earnings (realized and unrealized) that we have been allowed to withdraw in certain states prior to maturity. These earnings are recorded in Deferred preneed funeral revenues until the service is performed or the merchandise is delivered.

The table below sets forth certain investment-related activities associated with our preneed funeral merchandise and service trusts:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------|------------------------------------|-----------|
| | 2013 | 2012 | 2013 | 2012 |
| | (In thousands) | | (In thousands) | |
| Deposits | \$20,187 | \$19,982 | \$63,802 | \$64,081 |
| Withdrawals | 24,242 | 22,943 | 92,491 | 78,034 |
| Purchases of available-for-sale securities ⁽¹⁾ | 125,113 | 53,034 | 302,939 | 324,304 |
| Sales of available-for-sale securities ⁽¹⁾ | 91,064 | 51,672 | 337,714 | 323,471 |
| Realized gains from sales of available-for-sale securities | 12,953 | 7,681 | 41,654 | 43,446 |
| Realized losses from sales of available-for-sale securities | (2,212) | (4,570) | (8,378) | (18,730) |

(1) Reflects the rebalancing of Neptune Society trust assets during the current quarter.

The components of Preneed funeral receivables, net and trust investments in our unaudited condensed consolidated balance sheet at September 30, 2013 and December 31, 2012 are as follows:

| | September 30, 2013 | December 31, 2012 |
|--|-----------------------|----------------------|
| | (In thousands) | |
| Trust investments, at fair value | \$1,005,320 | \$977,973 |
| Cash and cash equivalents | 98,892 | 85,943 |
| Insurance-backed fixed income securities | 277,052 | 273,098 |
| Trust investments | 1,381,264 | 1,337,014 |
| Receivables from customers | 243,334 | 241,896 |
| Unearned finance charge | (9,653) | (8,645) |
| | 1,614,945 | 1,570,265 |
| Allowance for cancellation | (37,547) | (34,333) |
| Preneed funeral receivables, net and trust investments | \$1,577,398 | \$1,535,932 |

The cost and fair values associated with our funeral merchandise and service trust investments recorded at fair value at September 30, 2013 and December 31, 2012 are detailed below. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds, and private equity investments. Fair value represents the market value of the underlying securities held by the common trust funds, mutual funds at published values, and the estimated fair value of private equity investments (including debt as well as the estimated fair value related to the contract holder's equity in majority-owned real estate investments).

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| | September 30, 2013 | | | | |
|-----------------------------|----------------------------------|-----------|---------------------|----------------------|---------------|
| | Fair Value Hierarchy Level | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| | (In thousands) | | | | |
| Fixed income securities: | | | | | |
| U.S. Treasury | 2 | \$96,240 | \$1,699 | \$(4,499) | \$93,440 |
| Canadian government | 2 | 105,784 | 48 | (1,356) | 104,476 |
| Corporate | 2 | 50,520 | 2,864 | (739) | 52,645 |
| Residential mortgage-backed | 2 | 2,362 | 20 | (24) | 2,358 |
| Equity securities: | | | | | |
| Preferred stock | 2 | 4,649 | 547 | (50) | 5,146 |
| Common stock: | | | | | |
| United States | 1 | 225,447 | 61,091 | (3,989) | 282,549 |
| Canada | 1 | 23,793 | 2,912 | (1,635) | 25,070 |
| Other international | 1 | 18,444 | 4,065 | (509) | 22,000 |
| Mutual funds: | | | | | |
| Equity | 1 | 175,783 | 17,256 | (2,786) | 190,253 |
| Fixed income | 1 | 212,275 | 3,943 | (17,339) | 198,879 |
| Private equity | 3 | 30,811 | 3,533 | (7,359) | 26,985 |
| Other | 3 | 1,206 | 313 | — | 1,519 |
| Trust investments | | \$947,314 | \$98,291 | \$(40,285) | \$1,005,320 |
| | December 31, 2012 | | | | |
| | Fair Value Hierarchy Level | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| | (In thousands) | | | | |
| Fixed income securities: | | | | | |
| U.S. Treasury | 2 | \$105,594 | \$5,072 | \$(880) | \$109,786 |
| Canadian government | 2 | 110,399 | 861 | (113) | 111,147 |
| Corporate | 2 | 51,611 | 2,531 | (623) | 53,519 |
| Residential mortgage-backed | 2 | 3,123 | 57 | (8) | 3,172 |
| Asset-backed | 2 | 129 | 3 | — | 132 |
| Equity securities: | | | | | |
| Preferred stock | 2 | 3,603 | 211 | (103) | 3,711 |
| Common stock: | | | | | |
| United States | 1 | 230,971 | 38,514 | (6,903) | 262,582 |
| Canada | 1 | 23,284 | 2,598 | (1,271) | 24,611 |
| Other international | 1 | 18,089 | 1,874 | (658) | 19,305 |
| Mutual funds: | | | | | |
| Equity | 1 | 145,589 | 10,097 | (6,728) | 148,958 |
| Fixed income | 1 | 225,365 | 7,314 | (10,252) | 222,427 |
| Private equity | 3 | 36,626 | 221 | (18,968) | 17,879 |
| Other | 3 | 542 | 202 | — | 744 |
| Trust investments | | \$954,925 | \$69,555 | \$(46,507) | \$977,973 |

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Where quoted prices are available in an active market, securities held by the common trust funds and mutual funds are classified as Level 1 investments pursuant to the three-level valuation hierarchy as required by the Fair Value Measurements and Disclosure (FVM&D) Topic of the ASC.

Where quoted market prices are not available for the specific security, fair values are estimated by using either quoted prices of securities with similar characteristics or an income approach fair value model with observable inputs that include a combination of interest rates, yield curves, credit risks, prepayment speeds, rating, and tax-exempt status. These funds are classified as Level 2 investments pursuant to the three-level valuation hierarchy as required by the FVM&D Topic of the ASC.

The valuation of private equity and other alternative investments requires management judgment due to the absence of quoted market prices, inherent lack of liquidity, and the long-term nature of such assets. The fair value of these investments is estimated based on the market value of the underlying real estate and private equity investments. The underlying real estate value is determined using the most recent available appraisals. As of September 30, 2013, private equity instruments are valued based on reported net asset values discounted by 0% to 20% for risk and 0% to 10% for liquidity. As of December 31, 2012, private equity instruments are valued based on reported net asset values discounted by 0% to 60% for risk and 0% to 25% for liquidity. A significant increase (decrease) in the discounts results in a directionally opposite change in the fair value of the instruments. Valuation policies and procedures are determined by our Trust Services department, which reports to our Chief Financial Officer. Additionally, valuations are reviewed by our investment committee quarterly. These funds are classified as Level 3 investments pursuant to the three-level valuation hierarchy as required by the FVM&D Topic of the ASC.

As of September 30, 2013, our unfunded commitment for our private equity and other investments was \$8.3 million which, if called, would be funded by the assets of the trusts. Our private equity and other investments include several funds that invest in limited partnerships, distressed debt, real estate, and mezzanine financing. These investments can never be redeemed by the funds. Instead, the nature of the investments in this category is that the distributions are received through the liquidation of the underlying assets of the funds. We estimate that the underlying assets will be liquidated over the next 2 to 10 years.

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

| | Three Months Ended | | | |
|---|--------------------|---------|--------------------|-------|
| | September 30, 2013 | | September 30, 2012 | |
| | Private Equity | Other | Private Equity | Other |
| Fair market value, beginning balance | \$26,333 | \$1,457 | \$16,359 | \$909 |
| Net unrealized gains (losses) included in Accumulated other comprehensive income ⁽¹⁾ | 1,830 | 256 | (758) | 10 |
| Net realized losses included in Other income, net ⁽²⁾ | — | — | (11) | (1) |
| Contributions | 19 | — | 995 | — |
| Distributions and other | (1,197) | (194) | (316) | (4) |
| Fair market value, ending balance | \$26,985 | \$1,519 | \$16,269 | \$914 |
| | | | | |
| | Nine Months Ended | | | |
| | September 30, 2013 | | September 30, 2012 | |
| | Private Equity | Other | Private Equity | Other |
| Fair market value, beginning balance | \$17,879 | \$744 | \$15,986 | \$912 |
| Net unrealized gains (losses) included in Accumulated other comprehensive income ⁽¹⁾ | 14,441 | 1,126 | (2,342) | 10 |
| Net realized losses included in Other income, net ⁽²⁾ | (11) | (2) | (27) | (1) |
| Sales | — | — | (9) | — |
| Contributions | 2,221 | — | 3,554 | — |

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| | | | | | | | | |
|-----------------------------------|----------|---|---------|---|----------|---|-------|---|
| Distributions and other | (7,545 |) | (349 |) | (893 |) | (7 |) |
| Fair market value, ending balance | \$26,985 | | \$1,519 | | \$16,269 | | \$914 | |

All unrealized gains (losses) recognized in Accumulated other comprehensive income for our funeral merchandise and service trust investments are attributable to our preneed customers and are offset by a corresponding (1) reclassification in Accumulated other comprehensive income to Deferred preneed funeral and cemetery receipts held in trust. See Note 7 for further information related to our Deferred preneed funeral and cemetery receipts held in trust.

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- (2) All losses recognized in Other income, net for our funeral merchandise and service trust investments are attributable to our preneed customers and are offset by a corresponding reclassification in Other income, net to Deferred preneed funeral and cemetery receipts held in trust. See Note 7 for further information related to our Deferred preneed funeral and cemetery receipts held in trust.

Maturity dates of our fixed income securities range from 2013 to 2053. Maturities of fixed income securities, excluding mutual funds, at September 30, 2013 are estimated as follows:

| | Fair Value (In thousands) |
|--------------------------|------------------------------|
| Due in one year or less | \$132,664 |
| Due in one to five years | 44,840 |
| Due in five to ten years | 44,962 |
| Thereafter | 30,453 |
| | \$252,919 |

Earnings from all our funeral merchandise and service trust investments are recognized in funeral revenues when a service is performed or merchandise is delivered. Fees charged by our wholly-owned registered investment advisor are also included in current revenues in the period in which they are earned. In addition, we are entitled to retain, in certain jurisdictions, a portion of collected customer payments when a customer cancels a preneed contract; these amounts are also recognized in current revenues. Recognized trust fund income (realized and unrealized) related to these trust investments were \$11.4 million and \$8.5 million for the three months ended September 30, 2013 and 2012, respectively. Recognized trust fund income (realized and unrealized) related to these trust investments were \$35.7 million and \$27.7 million for the nine months ended September 30, 2013 and 2012, respectively.

We assess our trust investments for other-than-temporary declines in fair value on a quarterly basis. Impairment charges resulting from this assessment are recognized as investment losses in Other income, net and a decrease to Preneed funeral receivables, net and trust investments. These investment losses, if any, are offset by the corresponding reclassification in Other income, net, which reduces Deferred preneed funeral receipts held in trust. See Note 7 for further information related to our Deferred preneed funeral receipts held in trust. For both the three months ended September 30, 2013 and 2012, we recorded a \$0.2 million impairment charge for other-than-temporary declines in fair value related to unrealized losses on certain investments. For the nine months ended September 30, 2013 and 2012, we recorded a \$0.8 million and a \$0.7 million impairment charge, respectively, for other-than-temporary declines in fair value related to unrealized losses on certain investments.

We have determined that the remaining unrealized losses in our funeral merchandise and service trust investments are considered temporary in nature, as the unrealized losses were due to temporary fluctuations in interest rates and equity prices. The investments are diversified across multiple industry segments using a balanced allocation strategy to minimize long-term risk. We believe that none of the remaining securities are other-than-temporarily impaired based on our analysis of the investments. Our analysis included a review of the portfolio holdings and discussions with the individual money managers as to the sector exposures, credit ratings and the severity and duration of the unrealized losses. Our funeral merchandise and service trust investment unrealized losses, their associated fair values, and the duration of unrealized losses as of September 30, 2013 and December 31, 2012, respectively, are shown in the following tables:

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| | September 30, 2013 | | | | | |
|---------------------------------------|---|----------------------|--|----------------------|---------------|----------------------|
| | In Loss Position Less Than 12 Months | | In Loss Position Greater Than 12 Months | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (In thousands) | | | | | |
| Fixed income securities: | | | | | | |
| U.S. Treasury | \$29,033 | \$(3,230) | \$17,445 | \$(1,269) | \$46,478 | \$(4,499) |
| Canadian government | 23,989 | (1,100) | 6,252 | (256) | 30,241 | (1,356) |
| Corporate | 18,650 | (446) | 4,317 | (293) | 22,967 | (739) |
| Residential mortgage-backed | 1,322 | (23) | 19 | (1) | 1,341 | (24) |
| Equity securities: | | | | | | |
| Preferred stock | 1,214 | (50) | — | — | 1,214 | (50) |
| Common stock: | | | | | | |
| United States | 46,129 | (3,097) | 4,069 | (892) | 50,198 | (3,989) |
| Canada | 4,590 | (696) | 2,686 | (939) | 7,276 | (1,635) |
| Other international | 4,820 | (358) | 740 | (151) | 5,560 | (509) |
| Mutual funds: | | | | | | |
| Equity | 15,211 | (122) | 13,344 | (2,664) | 28,555 | (2,786) |
| Fixed income | 65,418 | (3,149) | 53,809 | (14,190) | 119,227 | (17,339) |
| Private equity | — | — | 13,687 | (7,359) | 13,687 | (7,359) |
| Total temporarily impaired securities | \$210,376 | \$(12,271) | \$116,368 | \$(28,014) | \$326,744 | \$(40,285) |
| | | | | | | |
| | | | | | | |
| | December 31, 2012 | | | | | |
| | In Loss Position Less Than 12 Months | | In Loss Position Greater Than 12 Months | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (In thousands) | | | | | |
| Fixed income securities: | | | | | | |
| U.S. Treasury | \$22,357 | \$(803) | \$6,741 | \$(77) | \$29,098 | \$(880) |
| Canadian government | 7,912 | (113) | — | — | 7,912 | (113) |
| Corporate | 7,809 | (347) | 4,283 | (276) | 12,092 | (623) |
| Residential mortgage-backed | 956 | (8) | — | — | 956 | (8) |
| Equity securities: | | | | | | |
| Preferred stock | 1,220 | (93) | 52 | (10) | 1,272 | (103) |
| Common stock: | | | | | | |
| United States | 70,752 | (4,694) | 9,089 | (2,209) | 79,841 | (6,903) |
| Canada | 6,592 | (652) | 2,516 | (619) | 9,108 | (1,271) |
| Other international | 7,606 | (521) | 608 | (137) | 8,214 | (658) |
| Mutual funds: | | | | | | |
| Equity | 6,779 | (126) | 26,340 | (6,602) | 33,119 | (6,728) |
| Fixed income | 38,686 | (1,021) | 24,131 | (9,231) | 62,817 | |