

# NEWSLETTER

## SCI LOSES ARBITRATION; TAKES \$15 MILLION CHARGE

In its 10Q filing with the Securities and Exchange Commission (August 7, 2003), Service Corporation International reported the result of a June, 2003 arbitration involving James P. Hunter III and the James P. Hunter Family Trust. The arbitration awarded Hunter and the Hunter Family Trust \$27.8 million including attorney's fees. Specifically, SCI reported the following:

*Litigants claimed violation of state (Texas) and federal securities laws. In addition, plaintiffs alleged that SCI must have been aware of the decline in profits before the merge was completed and failed to announce that information in a timely fashion.*

"The Hunter plaintiffs asserted claims against the Company and the Individual Defendants with respect to the Company's merger with ECI in 1999. Hunter also individually asserted claims that he was instructed to resign as an officer of the Company several months after the merger and suffered lost income as a result. The arbitration was held in June 2003. On August 6, 2003, the Company received the decision of the arbitration panel in the Hunter arbitration. **The amount of the award made under Texas securities laws was approximately \$27.8 million comprising amounts relating to ECI stock and ECI stock options held by claimants, and attorney fees.** (CFSA emphasis) The arbitration panel made no finding that the Company knew or should have known of facts that should have been disclosed to claimants. As a result of this decision, the **Company recognized \$15.0 million in general and ad-**

**ministrative expenses in the second quarter of 2003.** The recognition of this amount was necessary principally because one of the Company's insurance carriers that would have covered a portion of this decision is insolvent."

The lawsuit and arbitration related to SCI's acquisition of ECI in 1999. The purchase agreements (see CFSA Newsletter, January 1999) called for a per share price of SCI stock ranging from \$38 to \$41.50 per share. Shortly after the acquisition was completed, SCI reported that its earnings would be only \$.22 - \$.24 per share, \$.18 to \$.20 less than expected. SCI's stock price dropped more than \$15 on the announcement of reduced earnings. Litigants claimed violation of state (Texas) and federal securities laws. In addition, plaintiffs alleged that SCI must have been aware of the decline in profits before the merge was completed and failed to announce that information in a timely fashion.

Other lawsuits and arbitrations arising from the ECI acquisition include:

No. 2000-63917; Jack T. Hammer v. Service Corporation International, et al; in the 165th Judicial District Court of Harris County, Texas ("Hammer" matter);

No. 33701-01-01; Jack D. Rottman v. Service Corporation International, et al; in the District Court of Angelina County, Texas ("Rottman" matter); and

SEPTEMBER 2003

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*George W. Lemke*



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## SCI LOSES ARBITRATION (CONTINUED FROM PAGE 1)

No. 31820-99-2; Charles Fredrick, Individually, and as a Representative of the Class v. Service Corp. International; in the District Court of Angelina County, Texas.

Thomas G. Conway et al v. Service Corporation International, et al; Cause No. CV-02-2818; in the United States District Court for the Eastern District of New York, filed May 10, 2002 and Demand for Arbitration, No. 13 168 02061 02, before the American Arbitration Association (“AAA”/“Conway” action).

In Re Service Corporation International; Cause No. H-99-0280; in the United States District Court for the Southern District of Texas, Houston Division (the Consolidated Lawsuit). The plaintiffs in the Consolidated Lawsuit allege that defendants violated federal securities laws by making materially false and misleading statements and failing to disclose material information concerning the Company’s prearranged funeral business.

These cases have not been concluded.

SCI also is confronted with several lawsuits as a result of the problems that have been well-reported regarding Menorah Gardens Cemetery matters. The Company noted that its liability insurance might not cover all contingencies in these matters with the following comment in its 10Q.

“Certain insurance policies held by the Company to cover potential director and officer liability may reduce cash outflows with respect to an adverse outcome of the above lawsuits. **If an adverse decision in these matters exceeds the insurance coverage or if the insurance coverage is deemed not to apply to these matters, an adverse decision could have a material adverse effect on the Company, its financial condition, results of operations or cash flows.**” (CFSA emphasis)

## SCI ANNOUNCES CLASS ACTION CERTIFIED IN MENORAH GARDENS CASE

Service Corporation International announced on August 19, 2003 that in connection with the lawsuit involving two SCI-affiliated cemeteries in South Florida, the trial judge has issued a ruling certifying a class. The lawsuit is captioned Joan Light, Shirley Eisenbert and Carol Prisco v. SCI Funeral Services of Florida, Inc. d/b/a Menorah Gardens & Funeral Chapels, and Service Corporation International, Case No. 01-21376 CA 08, and was filed December 19, 2001 in the Circuit Court of the 17th Judicial Circuit in and for Broward County, Florida, General Jurisdiction Division. The lawsuit was brought on behalf of all persons with burial plots or family members buried at Menorah Gardens & Funeral Chapels in Florida. Excluded from the class definition are persons whose claims have been reduced to judgment or have been settled as of the date of class certification.

The Company is reviewing the trial judge's order to determine the appropriate response. The Company currently cannot quantify its ultimate liability, if any, for the payment of damages or predict the outcome of this pending litigation.

Reuters reported that the suit may involve up to 30,000 plaintiffs, according to plaintiff’s lawyers.

## FCC DELAYS FAX ENFORCEMENT

The Federal Communications Commission has decided to defer until 2005 enforcement of its decision to delete the established business relationship exception to sending fax messages.

Specifically, the FCC extended to January 1, 2005, the effective date of its new rules requiring written consent before sending advertising faxes.

The extension of time permits entities sending fax advertisements more time to comply with the new rules and obtain written consent and signatures from parties to whom they wish to fax. It will also allow the Commission time to consider any petitions for reconsideration and other filings that may be made on this issue.

This action does not change the effective date for the comprehensive telemarketing rules, including other rules regarding faxes, adopted on June 26, 2003. This action also does not change the October 1, 2003 effective date for the national do-not-call registry.

The extension keeps in effect, until January 1, 2005, the exemption that allows entities to send unsolicited fax advertisements to individuals and businesses with which they have established business relationships. Until January 1, 2005, those transmitting faxes do **not** have to obtain the express written consent, including signatures, from recipients with whom they have established business relationships. Regardless of the extension, however, **fax transmitters still must obtain prior express permission from fax recipients with whom they do not have established business relationships.**

**NFDA REPORTS MAIN FIRM MEMBERSHIP OF 9,467**

NFDA has released its membership information reporting that the number of main firm locations served now total 9,467, a six percent increase from last year's levels. Including branch locations, NFDA reports that it serves 12,271 locations. The NFDA provides the following breakdown:

Individual licensees	184
Apprentices	72
Retired	185
Students	107
Primary licensed contacts	8,222
Additional licensed members	11,567

It would be interesting to know the number of members that are affiliated with Alderwoods Group International, Carriage Services, Service Corporation International and Stewart Enterprises. These companies, and other privately held consolidators, collectively own about 3,000 locations. If they are minimally represented in NFDA, nearly 70% of the "roof tops" would be accounted for. Furthermore, if the remaining 7,000 or so roof tops have comparable ownership patterns (presuming that the 8,222 primary licensed contacts are the owners of 12,271 locations) then about 4,900 owners would not be represented within NFDA.

**FALL CONFERENCE PROGRAMS MAILED**

The Fall Conference Program, hotel reservation forms and CFSA pre-registration forms were mailed the week of August 11-15. Members are encouraged to register promptly and to return their ho-

tel reservations to the Crowne Plaza Hotel at Union Station in Indianapolis. The Crowne Plaza offers a new venue for this event. The facility is a substantial improvement over the Adam's Mark of-

fering markedly improved accommodations for hotel guests and all the amenities of downtown Indianapolis within walking distance of the hotel.

**CANA: CREMATION RATE IS 27.78%**

The Cremation Association of North America (CANA) on August 16, 2003 reported that the cremation rate in the US in 2002 was 27.78 percent. According to CANA, there were 676,890 cremations (based on preliminary estimates). According to the National Center for Health Statistics (*Vital Statistics Reports*) there were 2,436,467 deaths in 2002. Cremation data were incomplete for Illinois and Rhode Island and in a number of cases were estimated using 1997-2001 state data.

**CARRIAGE: SECOND QUARTER RESULTS EXCEED EXPECTATIONS**

Carriage Services on August 6, 2003 reported that its second quarter results before special items returned \$.10 per share in revenue and \$.13 per share after inclusion of gains attributable to the sale of funeral homes and cemetery property. Funeral revenues for the quarter were down slightly at \$28,702,000 from the prior year total of \$28,832,000. However, second quarter results were a substantial improvement over first quarter when the company reported call volume of 8.6%. In the second quarter, call volume was off 0.5% (22 calls).

Net revenue reported for the quarter was \$2,296,000. First half net revenue was \$4,352,000 about \$900,000 less than last year's first half net before including a special deferred tax asset of more than \$12 million.

Carriage also announced that it had arranged a new \$40 million bank credit facility with Bank of America and Wells Fargo Bank. The new financing eliminates the need for refinancing debt in 2004 and puts the next refinancing date in 2006. Financial covenants associated with the new credit facility require that interest payments on the company's \$90 million in convertible preferred trust securities (TIDES debt) be deferred. These charges, however, will continue to be accrued at a rate of about \$6.5 million per year. The TIDES debt accrues interest at a rate of 7% per annum. The deferred interest payments likewise will accrue interest at 7% per annum. For the time that Carriage defers paying interest on its convertible preferred trust securities, Carriage is prohibited from paying dividends on its common stock or repurchasing its common stock, with limited exceptions.

**CARRIAGE** (Continued from Page 3)

Carriage Services reported a nominal reduction in the number of cremation services from 29.2% to 29% and a 4.5% price increase for its cremation services.

## CARRIAGE SERVICES, INC. CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(in thousands except per share amounts)

	For Three Months Ended		For Six Months Ended	
	<u>6/30/02</u>	<u>6/30/03</u>	<u>6/30/02</u>	<u>6/30/03</u>
Funeral revenues	\$28,832	\$28,702	\$61,539	\$59,056
Funeral costs and expenses	21,544	21,590	42,568	43,312
Funeral gross profit	7,288	7,112	18,971	15,744
Funeral gross margin	25.3%	24.8%	30.8%	26.7%
Cemetery revenues	9,018	9,165	17,233	17,517
Cemetery costs and expenses	6,618	6,609	13,132	12,493
Cemetery gross profit	2,400	2,556	4,101	5,024
Cemetery gross margin	26.6%	27.9%	23.8%	28.7%
Total revenues	37,850	37,867	78,772	76,573
Total costs and expenses	28,162	28,199	55,700	55,805
Total gross profit	9,688	9,668	23,072	20,768
Total gross margin	25.6%	25.5%	29.3%	27.1%
General and administrative expenses	2,329	2,476	4,856	5,088
Special charges and other items	—	(896)	—	(308)
Operating income	7,359	8,088	18,216	15,988
Operating margin	19.4%	21.4%	23.1%	20.9%
Interest expense, Debt	3,246	2,741	6,349	5,677
Interest expense, TIDES	1,674	1,674	3,348	3,348
Total interest expense & financing costs	4,920	4,415	9,697	9,025
Income before income taxes	2,439	3,673	8,519	6,963

Continued on Page 5

**CARRIAGE SERVICES, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(unaudited)  
(in thousands except per share amounts)

	For Three Months Ended		For Six Months Ended	
	<u>6/30/02</u>	<u>6/30/03</u>	<u>6/30/02</u>	<u>6/30/03</u>
Provision for income taxes before the reduction of the deferred tax asset valuation allowance	962	1,377	3,282	2,611
Net Income before the reduction of the deferred tax asset valuation allowance	1,477	2,296	5,237	4,352
Reduction of the deferred tax asset valuation allowance	—	—	12,800	—
Net income for common stockholders	1,477	2,296	18,037	4,352
Basic earnings per share:				
Net income before reduction of deferred tax valuation allowance	\$0.09	\$0.13	\$0.31	\$0.25
Reduction of deferred tax valuation allowance	0.00	0.00	0.76	0.00
Net income	\$0.09	\$0.13	\$1.07	\$0.25
Diluted earnings per share:				
Net income before reduction of deferred tax valuation allowance	\$0.08	\$0.13	\$0.30	\$0.25
Reduction of deferred tax valuation allowance	0.00	0.00	0.73	0.00
Net income	\$0.08	\$0.13	\$1.03	\$0.25

**EMPLOYMENT COST UP 0.9%**

The Bureau of Labor Statistics reports that the Employment Cost Index (March—June, 2003) increased by 0.9% for civilian employees during the second quarter 2003. The second quarter increase followed a 1.3% gain during the first quarter. Cost increases

for private sector workers were slightly lower in the second quarter at 0.8% than for all civilian workers. Benefit costs for private sector workers rose 1.3% in the second quarter.

Compensation for union workers rose 5.0% during the year ending June 2003.

Wages and salaries increased 3% while benefit costs for union employees rose at an 8.7% clip. Non-union compensation costs increased 3.3% during the year. Wages and salaries at 2.5% rate and benefit costs rose at a 5.5% rate.



*THE KIDS ARE BACK IN SCHOOL.....  
BE CAREFUL ON THE ROADS*

## HILLENBRAND ANNOUNCES PURCHASE OF OUTSTANDING SECURITIES

On August 13, 2003, Hillenbrand Industries announced that its offer "to purchase outstanding securities expired at the scheduled expiration time of 5:00 p.m. EDT, on August 11, 2003. As of the expiration time, approximately \$157 million in aggregate face amount of outstanding debt securities had been tendered and accepted for purchase, for a total purchase price of approximately \$188 million (including market premium and accrued and unpaid interest on the securities). The Company will use cash on hand to finance the purchase of securities tendered pursuant to the offers."

### TAX LIEN FILED AGAINST CSE

According to a report in the *Scranton Times Tribune* (Courthouse Notes) on August 1, 2002

"The Internal Revenue Service has filed tax liens against . . . Casket Shells Inc., First Street, Eynon, for \$489,587.74."

J.R. Semon, President of Casket Shells, Inc. stated to this Editor, that the company is negotiating a resolution with the Internal Revenue Service.

## SCI MAY NO LONGER USE BONDS

CFO Jeffrey E. Curtis, in the course of the conference call with analysts, reported that the cost of bonding had increased and the company was considering trusting funds from pre-funded Florida funerals. This

action, according to the CFO, would reduce future company revenues by \$15-\$20 million. These revenues would be recognized when services were performed. Florida statutes require trusting of 70% of preneed

funeral funds (service charges); the greater of 110% of the wholesale cost of merchandise and 100% of cash advance items.

## SCI 2ND QUARTER RESULTS: FUNERAL REVENUES FLAT, CALL DOWNS SLIGHTLY

SCI reported second quarter gross revenues of \$586.2 million compared to \$583.4 million for 2002. Net income for the quarter was \$14.4 million (\$.05 per share) vs. a loss of \$143 million in the second quarter 2002. "Favorable currency effects in the company's French funeral operations helped to offset the negative impact from asset dispositions and decreases in the Company's North American cemetery revenues."

North American funeral revenues were \$282.1 million vs. \$282.9 million for the same period last year. International funeral revenues were \$144.3 million up from \$115.6 million in the prior year second quarter. The company performed 65,352 funerals in North America (down 1,050) from the same quarter in 2002 and 32,604 funerals in France (up 50 from 2002). Revenue per average funeral

increased \$91 in North America to \$4,151 vs. \$4,060 in the prior year. In France, the revenue per funeral was \$2,510, \$131 more than in 2002.

Funeral services performed in North America declined 1.6% to 68,208 during the second quarter compared to 69,729 funerals performed in North America in the second quarter of 2002. The company reported that sales were significantly lower in April and May before making somewhat of a turn-around in June.

39.3% of the services performed by the company in the second quarter 2003 were cremation services, up from 37.9% in the second quarter 2002. SCI reported that revenue per cremation service increased 2.7% due to increased use of Dignity Memorial® package cremation plans. 31.6% of funeral services performed by the com-

pany in North America had been previously prearranged during the quarter and the revenue for these funerals averaged \$4,021 in the second quarter 2003 vs. \$3,948 in the second quarter of 2002. Revenue for the average prearranged funeral was \$131 less than the revenue per average funeral in the second quarter.

SCI reported that it had reduced its total debt, less cash and cash equivalents, by \$206.4 million so far in 2003. Its outstanding debt as of June 30, 2003 was \$1,604,920,000 according to SCI, down from \$1,884,508,000 at the end of 2002. Deferred prearranged funeral contract revenues now total \$4,907,234,000 up nearly \$250 million from December, 2002. Deferred preneed cemetery revenues total \$1,646,513,000 down about \$26 million.

**SERVICE CORPORATION INTERNATIONAL**  
**CONSOLIDATED STATEMENT OF OPERATIONS**

(in thousands except per share amounts)

	For Three Months Ended June 30		For Six Months Ended June 30	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Revenues:				
Funeral	\$427,567	\$406,806	\$866,854	\$855,147
Cemetery	158,675	176,617	299,481	329,542
	586,242	583,423	1,166,334	1,184,689
Gross Profits				
Funeral	67,576	65,762	154,825	166,547
Cemetery	26,842	25,511	52,148	43,890
	94,418	91,273	206,973	210,437
General and administrative expenses	(36,268)	(19,592)	(57,679)	(35,323)
Gains and impairment (losses) on dispositions, net	(1,519)	(187,709)	7,815	(190,621)
Other operating expenses	(1,724)	(40,807)	(1,724)	(40,807)
Operating income (loss)	54,907	(156,835)	155,385	(56,314)
Interest expense	(36,121)	(41,406)	(73,517)	(84,792)
Other income (expense), net	2,398	(1,984)	6,410	6,200
Income (loss) before income taxes and cumulative effect of accounting change	21,184	(200,225)	88,278	(134,906)
(Provision) benefit for income taxes	(6,805)	57,210	(31,630)	38,740
Income (loss) before cumulative effect of accounting change	14,379	(143,015)	56,648	(96,166)
Cumulative effect of accounting change (net of income tax benefit of \$11,234)	—	—	—	(135,560)
Net income (loss)	\$14,379	\$(143,015)	\$56,648	\$(231,726)
Basic earnings (loss) per share:				
Income (loss) before cumulative effect of accounting change	\$0.05	\$(0.49)	\$0.19	\$(0.33)
Cumulative effect of accounting change	—	—	—	(0.46)
Net income (loss)	\$0.05	\$(0.49)	\$0.19	\$(0.79)

## MATTHEWS' 10Q ADDS DETAIL RE. REVENUES

Matthews International, in its 10Q filing with the Securities and Exchange Commission reported that sales for the "York Casket segment were \$92.4 million for the first nine months of fiscal 2003 compared to \$74.0 million for the same period last year. However, for the quarter ended June 30, 2003, York Casket sales were \$2.9 million, or 9.2%, lower than the same quarter a year ago primarily reflecting a decline in metal casket and casket component sales.

"Bronze segment sales for the first nine months of fiscal 2003 were \$137.7 million compared to \$136.5 million for the first nine months of fiscal 2002. The slight increase of approximately 1.0% in Bronze sales reflected the favorable impact of increases in the values of the Euro and the Australian and Canadian dollars against the U.S. dollar offset partially by a decline in mausoleums sales, the divestiture of the segment's granite import business in fiscal 2002 and the divestiture of a Canadian niche bank and columbarium business in October 2002. Sales for the Graphics Imaging segment in the first nine months of fiscal 2003 were \$71.7 million, compared to \$70.0 million for the same period a year ago. The increase primarily reflected higher sales in the segment's European operations combined with an increase in the value of the Euro against the U.S. dollar. These increases were partially offset by lower sales in the seg-

*Gross profit for all of the Company's segments increased for the nine-month period.*

ment's domestic operations, which primarily related to weak demand and price pressure in the United States primary and corrugated packaging markets and the closure, in October 2002, of an unprofitable manufacturing business in Southern California. Marking Products segment sales for the nine months ended June 30, 2003 were \$23.9 million, compared to \$20.9 million for the first nine months of fiscal 2002. The increase of \$3.0 million, or 14.2%, was principally due to higher volume, reflecting higher

demand in North America and the addition of new distributors in Europe, and higher foreign currency exchange rates. Sales for the Cremation segment were \$15.1 million for the first nine months of fiscal 2003 compared to \$12.8 million for the same period a year ago. The increase reflected two additional months of cremation casket sales compared to the same period last year as a result of the acquisition of York Casket.

"Beginning with the first quarter of fiscal 2003, Matthews changed its internal reporting structure and is reporting a fifth business segment, the Cremation segment. The Cremation segment consists of the Company's cremation equipment business (formerly part of the Bronze segment) and the Company's cremation casket business (formerly part of the York Casket segment). The objective of the new segment, which is expected to generate approximately

\$20 million in sales for fiscal 2003, is to focus on the fastest growing segment of the death care industry, which is cremation products and services and increase the Company's participation in this market. Segment information for the prior periods contained in this report has been reclassified to conform to the current period presentation.

"Gross profit for the nine months ended June 30, 2003 was \$126.0 million, compared to \$117.0 million for the nine months ended June 30, 2002. The increase in consolidated gross profit primarily resulted from the acquisition of York Casket, higher sales in the Marking Products and European Graphics Imaging businesses and manufacturing improvements in the Bronze segment. Gross profit for all of the Company's segments increased for the nine-month period. In addition, gross profit for the Bronze segment reflected the benefit of a reduction in the segment's pre-need memorial finishing cost liability due to manufacturing efficiencies. Consolidated gross profit as a percent of sales declined slightly from 37.2% for the first nine months of fiscal 2002 to 37.0% for the first nine months of fiscal 2003. The reduction in the consolidated gross margin principally related to the additional York Casket revenues, which generally have lower margins than other Matthews segments, and an increase in pension and health care costs in fiscal 2003."

## CLARKSBURG TO CLOSE; PRODUCTION MOVED TO BRISTOL, TN

Aurora Casket Company on Wednesday, August 27, 2003 announced the closing of the Clarksburg Casket Company facility in Clarksburg, WV effective August 31, 2003. Hardwood manufacturing processes will be relocated to Aurora's facility in Bristol, TN which has 84 employees and 150,000 square feet of manufacturing space. Aurora acquired the Bristol facility in March 2003 when it purchased the assets of Cortrim Hardwood Parts Company.

David Lane, speaking for Aurora Casket Company, said "Despite the best efforts of the company and the Teamsters Union, other obstacles to the long-term viability of the operation proved too great, including Worker's Compensation insurance, Environmental Operating issues and Health Care costs."