

SERVICE CORPORATION INTERNATIONAL

Form 10-K

March 02, 2009

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K**

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008**
- OR**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 1-6402-1**

Service Corporation International
(Exact name of registrant as specified in its charter)

Texas
*(State or other jurisdiction of
incorporation or organization)*

74-1488375
*(I.R.S. employer
identification no.)*

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

77019
(Zip code)

**Registrant's telephone number, including area code:
713/522-5141**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class
Common Stock (\$1 par value)

Name of Each Exchange on Which Registered
New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act:
None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. b

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 b

Non-accelerated filer o (Do not check if a smaller reporting company)

Accelerated filer o

Smaller Reporting
company o

Indicate by check mark whether the registrant is a shell company (as defined in the Securities Exchange Act of 1934 Rule 12b-2). Yes o No b

The aggregate market value of the common stock held by non-affiliates of the registrant (assuming that the registrant's only affiliates are its officers and directors) was \$2,409,933,852 based upon a closing market price of \$9.86 on June 30, 2008 of a share of common stock as reported on the New York Stock Exchange Composite Transactions Tape.

The number of shares outstanding of the registrant's common stock as of February 20, 2009 was 250,932,474 (net of treasury shares)

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement in connection with its 2009 Annual Meeting of Shareholders (Part III)

SERVICE CORPORATION INTERNATIONAL

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GLOSSARY

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

Atneed Funeral and cemetery arrangements initiated after a death has occurred.

Burial Vaults A reinforced container intended to house and protect the casket before it is placed in the ground.

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

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.

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 can occur prior to death).

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

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

Preneed Purchase of products and services prior to use.

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

Production Sales of preneed funeral and preneed or atneed cemetery contracts.

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

Item 1. *Business.*

General

Service Corporation International (SCI) is North America's leading provider of deathcare products and services, with a network of funeral homes and cemeteries unequalled in geographic scale and reach. At December 31, 2008, we operated 1,302 funeral service locations and 369 cemeteries (including 208 combination locations) in North America, which are geographically diversified across 43 states, eight Canadian provinces, the District of Columbia, and Puerto Rico. Our funeral segment also includes the operations of 12 funeral homes in Germany that we intend to exit when economic values and conditions are conducive to a sale. As part of our Alderwoods Group, Inc. (Alderwoods) acquisition in the fourth quarter of 2006, we acquired Mayflower National Life Insurance Company (Mayflower), an insurance business that we sold in July 2007. The operations of this business through the date of sale are presented as discontinued operations in our consolidated statement of operations.

History

We were incorporated in Texas in July of 1962. Our original business plan was based on efficiencies of scale, specifically reducing overhead costs by sharing resources such as embalming, accounting, transportation, and personnel among funeral homes in a business cluster. After proving the plan's effectiveness in Houston in the early 1960s, SCI set out to apply this operating strategy through the acquisition of death care businesses in other markets. It was the beginning of a three-decade period of expansion that would create a North American network of nearly 1,400 funeral homes and cemeteries by the end of 1992. Beginning in 1993, we expanded beyond North America, acquiring major death care companies in Australia, the United Kingdom, and France, plus smaller holdings in other European countries and South America. By the end of 1999, our global network numbered more than 4,500 funeral service locations, cemeteries, and crematories in 20 countries.

During the mid to late 1990s, acquisitions of deathcare facilities became extremely competitive, resulting in increased prices for acquisitions and substantially reduced returns on invested capital. In 1999, we significantly reduced our level of acquisition activity and over the next several years implemented various initiatives to pay down debt, increase cash flow, reduce overhead costs, and increase efficiency. We divested most of our international businesses and many North American funeral homes and cemeteries that were either underperforming or did not fit our long-term strategy. At the same time we began to capitalize on the strength of our network by introducing to North America the first transcontinental brand of death care services and products—Dignity Memorial® (See www.dignitymemorial.com)

In late 2006, having arrived at a position of significant financial strength and improved operating efficiency, we acquired our biggest competitor, Alderwoods. By combining the two leading companies in the deathcare industry, we are able to realize more than \$90 million in annual pretax cost synergies, savings, and revenue enhancement opportunities.

Funeral and Cemetery Operations

Worldwide, we have 1,314 funeral service locations and 369 cemeteries (including 208 combination locations) covering 43 states, eight Canadian provinces, the District of Columbia, Puerto Rico, and Germany. See Note 16 in Part II, Item 8. Financial Statements and Supplementary Data, for financial information about our business segments and geographic areas.

Our funeral service and cemetery operations consist of funeral service locations, cemeteries, funeral service/cemetery combination locations, crematoria, and related businesses. We 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, burial vaults, cremation receptacles, flowers, and other ancillary products and services, is sold at funeral service locations. Our cemeteries provide cemetery property interment rights, including mausoleum spaces, lots, and lawn crypts, and sell cemetery related merchandise and services, including stone and bronze memorials, burial vaults, casket and cremation memorialization products,

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merchandise installations, and burial openings and closings. We also sell preneed funeral and cemetery products and services whereby a customer contractually agrees to the terms of certain products and services to be delivered and performed in the future. As a result of these preneed sales, our backlog of unfulfilled contracts was \$6.2 billion and \$6.7 billion at December 31, 2008 and 2007, respectively.

Funeral service/cemetery combination locations are those businesses in which a funeral service location is physically located within or adjoining a cemetery that we own. Combination locations allow certain facility, personnel, and equipment costs to be shared between the funeral service location and cemetery. Such combination facilities typically can be cost competitive and have higher gross margins than if the funeral and cemetery operations were operated separately. Combination locations also create synergies between funeral and cemetery sales force personnel and give families added convenience to purchase both funeral and cemetery products and services at a single location. With the acquisition of Alderwoods, we acquired Rose Hills, which is the largest combination operation in the United States, performing over 5,000 funeral services and 8,500 interments per year.

Our operations in the United States and Canada are organized into 37 major markets and 45 middle markets (including eight Hispana markets). Each market is led by a market director with responsibility for funeral and/or cemetery operations and preneed sales. Within each market, the funeral homes and cemeteries share common resources such as personnel, preparation services, and vehicles. There are four market support centers in North America to assist market directors with financial, administrative, pricing, and human resource needs. These support centers are located in Houston, Miami, New York, and Los Angeles. The primary functions of the support centers are to help facilitate the execution of corporate strategies, coordinate communication between the field and corporate offices, and serve as liaisons for the implementation of policies and procedures.

The following table (which includes businesses held-for-sale at December 31, 2008) provides the number of our funeral homes and cemeteries by country, and by state, territory, or province:

Country, State/Territory/Province	Number of Funeral Homes	Number of Cemeteries	Total
United States			
Alabama	31	9	40
Arizona	30	11	41
Arkansas	10		10
California	118	32	150
Colorado	23	11	34
Connecticut	16		16
District of Columbia	1		1
Florida	113	52	165
Georgia	40	20	60
Hawaii	2	1	3
Idaho	2	1	3
Illinois	40	25	65
Indiana	27	8	35
Iowa	4	2	6
Kansas	8	2	10
Kentucky	12	3	15

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Louisiana	27	5	32
Maine	10		10
Maryland	12	7	19
Massachusetts	28		28
Michigan	24		24
Minnesota	10	2	12

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Country, State/Territory/Province	Number of Funeral Homes	Number of Cemeteries	Total
Mississippi	24	2	26
Missouri	17	3	20
Montana	4		4
Nebraska	2		2
Nevada	3	1	4
New Hampshire	6		6
New Jersey	20		20
New York	73	1	74
North Carolina	43	11	54
Ohio	18	11	29
Oklahoma	15	7	22
Oregon	10	3	13
Pennsylvania	17	17	34
Puerto Rico	4	5	9
Rhode Island	4		4
South Carolina	3	5	8
Tennessee	33	14	47
Texas	146	55	201
Utah	3	3	6
Virginia	27	12	39
Washington	34	12	46
West Virginia	5	6	11
Wisconsin	8		8
Canada			
Alberta	15		15
British Columbia	34	7	41
Manitoba	4	3	7
New Brunswick	5		5
Nova Scotia	12		12
Ontario	46		46
Quebec	57		57
Saskatchewan	22		22
Germany	12		12
Total	1,314	369	1,683

We believe we have satisfactory title to the properties owned and used in our business, subject to various liens, encumbrances, and easements, which are incidental to ownership rights and uses and do not materially detract from the value of the property. We also lease a number of facilities that we use in our business under both capital and operating leases.

At December 31, 2008, we owned approximately 91% of the real estate and buildings used at our facilities, and the remainder of the facilities were leased. At December 31, 2008, our 369 cemeteries contained a total of approximately 26,007 acres, of which approximately 63% was developed.

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A map of our locations in North America is presented below:

Competition

Although there are several public companies that own funeral homes and cemeteries, the majority of deathcare businesses are locally-owned, independent operations. We estimate that our funeral and cemetery market share in North America is approximately 12% based on estimated total industry revenues. The position of a single funeral home or cemetery in any community is a function of the name, reputation, and location of that funeral home or cemetery, although competitive pricing, professional service and attention, and well-maintained locations are also important.

We believe we have an unparalleled network of funeral service locations and cemeteries that offer high quality products and services at prices that are competitive with local competing funeral homes, cemeteries, and retail locations. Within this network, the funeral service locations and cemeteries operate under various names as most operations were acquired as existing businesses. We have branded our funeral operations in North America under the name Dignity Memorial®. We believe our transcontinental branding strategy gives us a strategic advantage and identity in the industry. While this branding process is intended to emphasize our seamless national network of funeral service locations and cemeteries, the original names associated with acquired operations, and their inherent goodwill and heritage, generally remain the same. For example, Geo. H. Lewis & Sons Funeral Directors is now Geo. H. Lewis & Sons Funeral Directors, a Dignity Memorial® provider.

Strategies for Growth

Currently, we are relying on our strong competitive position and financial strength to remain a solid leader in our industry, despite the depressed state of the overall economy. We remain optimistic that as economic conditions begin to improve, our principal growth strategies will allow us to resume profitable growth over the long-term. Our strategies are as follows:

Target Our Customer

During 2008 we continued to build on the extensive consumer research we conducted to develop a cohesive marketing and sales program that targets profitable customer segments we believe are most receptive to planning.

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Coupled with very specialized training for our sales staff, the launch of our marketing/sales program during the second half of 2008 in select markets began to validate our research. The combination of targeted direct mail, select media advertising, and a revitalized team approach from our sales organization is generating quality leads that our sales team is able to close at a high rate. We expect to expand the program into other Dignity Memorial® markets throughout 2009.

As a component of this new marketing/sales approach, we are also working to strengthen our ties to the military community. Long a supporter of United States veterans through Community Outreach programs such as the Dignity Memorial Homeless Veterans Burial Program, we have now developed a planning guide for veterans that details their benefits available through the Veterans Administration, as well as special benefits and burial options available to them through Dignity Memorial® providers. Coupled with direct mail and advertising programs in select markets, we are seeing lead generation and sales success in this program as well. Our plan is to expand this program throughout 2009 in other markets.

During 2008 we launched Dignity Planning, an end-of-life planning tool available via the web, phones or in a paper version. This planning tool reaches customers we might not ordinarily contact, allowing families who are in the process of estate planning the opportunity to plan a funeral in which they detail the type of services and products they would like. The total cost is then used as a basis for the amount of insurance coverage they need. Although use of the Dignity Planning tool does not require that consumers designate a Dignity Memorial® provider, our preliminary results indicate that most consumers do choose a Dignity provider. We currently have agreements in place with several insurance companies and insurance marketing organizations to have their sales teams sell through Dignity Planning, and we plan to expand that network throughout 2009. Additionally, we have validated that consumers, via web search, will use Dignity Planning for their end-of-life plans. In 2009, we will continue to expand our online keyword search presence to make Dignity Planning a more prevalent and visible site for people wishing to create end-of-life plans.

Drive Operating Discipline and Leverage Our Scale

We continue to improve our infrastructure through standardization of processes and the usage of key performance metrics for staffing and other operational and administrative activities. One area of focus in 2008 that continued from the previous year was an ongoing review of our location staffing levels to ensure that we are aligning our funeral, cemetery and central care resources appropriately with our volume of business. In 2009 we expect to expand these efficiency reviews and metrics to other areas of our business. Additionally, in 2008 we began to focus on gaining better companywide leverage of our purchasing spend to reduce the total cost of materials, goods and services. This involved identifying opportunities to consolidate our supplier base, modifying processes and policies for more efficient purchasing and employing metrics to manage and improve supplier performance. We expect this discipline around our supply chain activities to mature in the coming year.

Manage and Grow the Footprint

We are managing our network of business locations by positioning each business location to support the preferences of its local customer base while monitoring each market for changing demographics and competitive dynamics. We are also looking to optimize our portfolio through strategic market reviews. We expect to pursue selective business expansion through construction or targeted acquisitions of cemeteries and funeral homes with a focus on the highest return customer categories. Over the long term, our size and scale also allow us the opportunity to pursue a franchise business model, which could drive incremental revenue at very little cost.

Employees

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At December 31, 2008, we employed 13,581 (13,550 in North America) individuals on a full-time basis and 7,190 (7,180 in North America) individuals on a part-time basis. Of the full-time employees, 12,820 were employed in the funeral and cemetery operations and 761 were employed in corporate or other overhead activities and services. All eligible employees in the United States who so elect are covered by our group health and life insurance plans. Eligible employees in the United States are participants in retirement plans of SCI or various subsidiaries, while international employees are covered by other SCI (or SCI subsidiary) defined or government mandated

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benefit plans. Approximately 3.6% of our employees in North America are represented by unions. Although labor disputes occur from time to time, relations with employees are generally considered favorable.

Regulation

Our operations are subject to regulations, supervision, and licensing under numerous foreign, federal, state, and local laws, ordinances, and regulations, including extensive regulations concerning trust funds, preneed sales of funeral and cemetery products and services, and various other aspects of our business. We strive to comply in all material respects with the provisions of these laws, ordinances, and regulations. Since 1984, we have operated in the United States under the Federal Trade Commission (FTC) comprehensive trade regulation rule for the funeral industry. The rule contains requirements for funeral industry practices, including extensive price and other affirmative disclosures and imposes mandatory itemization of funeral goods and services.

Other

Our corporate headquarters are located at 1929 Allen Parkway, Houston, Texas 77019. The property consists of approximately 120,000 square feet of office space and 185,000 square feet of parking space. We own and utilize an additional building located in Houston, Texas for corporate activities containing a total of approximately 38,000 square feet of office space. We also lease approximately 29,000 square feet of office space in Houston, Texas, which we utilize for corporate activities.

We make available free of charge, on or through our website, our annual, quarterly, and current reports and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission (SEC). Our website is <http://www.sci-corp.com> and our telephone number is (713) 522-5141. The SEC also maintains an internet site at <http://www.sec.gov> that contains reports, proxy and information statements, and other information regarding issuers that file electronically. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

Each of our Board of Directors' standing committee charters, our Corporate Governance Guidelines, our Code of Ethics for Board Members, and our Code of Conduct for Officers and Employees are available, free of charge, through our website or, upon request, in print. We will post on our internet website all waivers to or amendments of our Code of Conduct for Officers and Employees, which are required to be disclosed by applicable law and rules of the New York Stock Exchange listing standards. Information contained on our website is not part of this report.

Item 1A. Risk Factors.

Cautionary Statement on Forward-Looking Statements

The statements in this Form 10-K that are not historical facts are forward-looking statements made in reliance on the safe harbor protections provided under the Private Securities Litigation Reform Act of 1995. These statements may be accompanied by words such as believe, estimate, project, expect, anticipate, or predict that convey the uncertainty of future events or outcomes. These statements are based on assumptions that we believe are reasonable; however, many important factors could cause our actual consolidated results in the future to differ materially from the forward-looking statements made herein and in any other documents or oral presentations made by, or on behalf of, the Company. These factors are discussed below. We assume no obligation to publicly update or revise any forward-looking statements made herein or any other forward-looking statements made by the Company, whether as a result of new information, future events, or otherwise.

Our affiliated funeral and cemetery trust funds own investments in equity securities, fixed income securities, and mutual funds, which are affected by market conditions that are beyond our control.

Our affiliated funeral and cemetery trust funds own investments in equity securities, fixed income securities and mutual funds. Our earnings and losses and gains on these investments are affected by market conditions that are

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beyond our control. In 2008, the value of our trust funds was significantly and adversely impacted by market volatility, particularly in the fourth quarter of 2008.

The following table summarizes our investment losses and returns (realized and unrealized), excluding fees, on our trust funds for the fourth quarter of 2008 and the last three years ended December 31.

	Q4 2008	2008	2007	2006
Preneed funeral trust funds	(13.2)%	(23.5)%	9.9%	8.8%
Cemetery merchandise and service trust funds	(15.7)%	(26.9)%	9.8%	8.4%
Perpetual care trust funds	(8.0)%	(15.4)%	3.2%	10.8%

Generally, earnings or gains and losses on our trust investments are recognized, and we withdraw cash, when the underlying service is performed, merchandise is delivered, or upon contract cancellation; however, our cemetery perpetual care trusts recognize earnings, and in certain states, capital gains and losses, and we withdraw cash, when we incur qualifying cemetery maintenance costs. Therefore, unless market conditions improve and the value of our trust investments recover, our results of operations and cash flows will be negatively impacted in 2009 and perhaps in future years as we recognize over time the unrealized losses in our trusts.

If our trust funds experience additional significant investment losses in 2009 or subsequent years, there could be insufficient funds in the trusts to cover the costs of delivering services and merchandise or maintaining cemeteries in the future. We would have to cover any such shortfall with cash flows from operations, which could have a material adverse effect on our financial condition, results of operations, or cash flows. For more information related to our trust investments, see Notes 4, 5, and 6 in Part II, Item 8. Financial Statements and Supplementary Data.

If the fair market value of these trusts, plus any other amount due to us upon delivery of the associated contracts, were to decline below the estimated costs to deliver the underlying products and services, we would record a charge to earnings to record a liability for the expected losses on the delivery of the associated contracts. As of December 31, 2008, no such charge was required. For additional information, see Critical Accounting Policies in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

We may be required to replenish our affiliated funeral and cemetery trust funds in order to meet minimal funding requirements, which would have a negative affect on our earnings and cash flow.

In certain states and provinces, we have withdrawn allowable distributable earnings including unrealized gains prior to the maturity or cancellation of the related contract. Additionally, some states have laws that either require replenishment of investment losses under certain circumstances or impose various restrictions on withdrawals of future earnings when trust fund values have dropped below certain prescribed amounts. In the event of market declines, we may be required to deposit portions or all of these amounts into the respective trusts in some future period. As of December 31, 2008, we had unrealized losses of \$19.8 million in the various trusts in these states. See Off-Balance Sheet Arrangements, Contractual Obligations, and Commercial and Contingent Commitments in Part II, Item 7.

Our ability to execute our strategic plan depends on many factors, some of which are beyond our control.

Our strategic plan is focused on cost management and the continued implem