



Lower mortality rate killing funeral business. (Money).



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Malcolm Berko

Dear Mr. Berko:

Please tell me what you can about Service Corp., the funeral company. The stock sells for \$3, and I clearly remember that back in 1997-98, this was a hot stock. At the current price, it looks down and out. I would like to know if you think it would be a good speculation for me to buy 1,000 shares, which would cost \$3,000. I heard you recommend the stock at \$2.75 while listening to your Internet radio show last year. My brother-in-law is a mortician at a funeral home that used to be owned by Service Corp. He bought 1,000 shares because he believes the company is going to make a comeback.

W. L., Destin, Fla.

Dear W.L.:

The good news: We are living longer, thanks to improved health care and better nutrition. The bad news: As a result, the funeral home business, once considered recession- and inflation-proof, is dying. Yes, I did recommend Service Corp. at \$2.75 in July and it's up 25 cents (about 9 percent), which seems to be little better than the Dow in that time frame.

Only 2.26 million people went to their final parking spaces in the sky in 2002 versus 2.3 million the year before, according to the U.S. Census Bureau. That represents a 2 percent decline. The numbers for 2001 were down 5.3 percent from the year before.

Service Corp. (SRV-\$3), which was one of the most beloved Wall Street darlings in the 1990s, has watched its revenues reflect this trend. Revenues in 1999 were \$3.3 billion and have declined steadily each year to \$2.2 billion in 2002. That's a 33 percent drop. SRV also lost money in each of those years, cumulatively totaling more than \$1 billion.

Most newly bereaved are electing cremation, purchasing Less-expensive coffins and demanding less-lavish services; bare-bones funerals seem to be the trend. According to the Centers for Disease

Control, U.S. deaths will probably remain flat for the next 15 years. If so, that kind of lowers the curtains on margins in the funeral industry, where SRV is the world's largest service provider.

In 2000, SRV owned 3,382 funeral services locations; in 2001, that number fell to 3,089; and in 2002, it fell again to 2,654 locations. As of April, SRWS funeral service locations dwindled to 2,393, putting a lid on future growth.

SRV faces stiff competition from a growing number of independent funeral homes. Most of these independent funeral homes were once owned by SRV. In the past few years, many of those independents were able to repurchase their autonomy because SRV was in a cash crunch. Now they are aggressively bleeding revenues from SRV.

A Service Corp. funeral includes excessive costs to support SRV's corporate headquarters and staff in Houston. On average, the same funeral at an independent home might cost 25 percent to 30 percent less. When someone passes on, it really pays to shop price.

SRV has, over the past three years, unloaded most of its unprofitable assets. It sold many of its foreign operations and has plans to sell about 140 more North American funeral homes, as well as various cemetery and crematory operations. Management is restructuring a large portion of its maturing debt with favorable terms and longer maturities and has successfully accelerated its asset liquidation to meet its debt requirements. Headquarters has done yeoman's work reducing debt from \$3.7 billion-a few years ago to \$1.8 billion today.

I believe that SRV's operating margins may improve nicely this year due to lower interest costs, staff reduction at headquarters and elimination of unprofitable assets. After losing more than \$1 billion in the last four years, the suits on the Street figure SRV could earn 30 to 40 cents a share in 2003. Value Line reckons SRV will earn \$1, but I think that is too optimistic. If you wish to speculate with 1,000 shares and shoot the moon, I won't object. There are four suits who follow the stock, two of whom rank SRV as a "buy" and two rate it a "hold."

However, there is a recent and significant potential liability in Florida regarding the improper handling of human remains, which may morph into civil as well as criminal damages, and that concerns me. Personally, I don't believe the stock is timely, but on a three- to five-year-horizon, the shares could have good appreciation potential for a patient investor.

Please address your financial questions to Malcolm Berko, P.O. Box 1416, Boca Raton, Fla. 33429 or visit his Web site at www.berkoradio.com.

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