

SERVICE CORPORATION INTERNATIONAL
Form 10-Q
August 08, 2008

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549
FORM 10-Q**

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

For the quarterly period ended June 30, 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 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 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 a 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 August 1, 2008 was 257,162,143 (net of treasury shares).

**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 after the death has occurred.

Burial Vaults A reinforced outer burial container intended to protect the casket against the weight of the earth.

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

General Agency (GA) Revenues Commissions paid to the General Agency (GA) for life insurance policies or annuities sold to preneed customers for the purpose of funding 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 outer burial receptacle constructed of concrete and reinforced steel, which is usually pre-installed in predetermined designated areas.

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

Maturity At the time of death. This is the point at which preneed contracts are converted to atneed contracts.

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

Cemetery Perpetual Care or Endowment Care Fund A trust fund used for the maintenance and upkeep of burial spaces within a cemetery in 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.

PART I. FINANCIAL INFORMATION**Item 1. Financial Statements**

SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

(In thousands, except per share amounts)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Revenues	\$ 548,782	\$ 565,492	\$ 1,122,233	\$ 1,173,047
Costs and expenses	(441,422)	(462,253)	(877,276)	(928,825)
Gross profit	107,360	103,239	244,957	244,222
General and administrative expenses	(21,658)	(30,159)	(46,733)	(65,387)
(Loss) gain on divestitures and impairment charges, net	(3,858)	9,743	(15,904)	2,063
Other operating income, net	1,691		585	
Operating income	83,535	82,823	182,905	180,898
Interest expense	(33,311)	(36,165)	(67,380)	(73,762)
Loss on early extinguishment of debt		(12,122)		(14,480)
Equity in earnings of unconsolidated subsidiaries		5,559		6,270
Other income, net	1,945	1,755	3,117	1,138
Income from continuing operations before income taxes	52,169	41,850	118,642	100,064
Provision for income taxes	(20,395)	(28,941)	(45,364)	(52,438)
Income from continuing operations	31,774	12,909	73,278	47,626
(Loss) income from discontinued operations (net of income tax (benefit) provision of \$(195), \$1,223, \$(195), and \$1,960, respectively)	(377)	2,209	(362)	5,134
Net income	\$ 31,397	\$ 15,118	\$ 72,916	\$ 52,760
Basic earnings per share:				
Income from continuing operations	\$.12	\$.04	\$.28	\$.16
Income from discontinued operations, net of tax		.01		.02
Net income	\$.12	\$.05	\$.28	\$.18
Diluted earnings per share:				
Income from continuing operations	\$.12	\$.04	\$.28	\$.16
Income from discontinued operations, net of tax		.01		.02
Net income	\$.12	\$.05	\$.28	\$.18
Basic weighted average number of shares	259,034	290,577	259,919	291,941

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Diluted weighted average number of shares	262,575	296,124	263,712	297,480
Dividends declared per share	\$.04	\$.03	\$.08	\$.06

(See notes to unaudited condensed consolidated financial statements)

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SERVICE CORPORATION INTERNATIONAL
CONDENSED CONSOLIDATED BALANCE SHEET
(UNAUDITED)
(In thousands, except share amounts)

	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	\$ 104,700	\$ 168,594
Receivables, net	90,936	113,793
Inventories	33,008	36,203
Deferred tax asset	73,182	73,182
Current assets held for sale	1,805	2,294
Other	27,480	27,261
Total current assets	331,111	421,327
Preneed funeral receivables and trust investments	1,398,503	1,434,403
Preneed cemetery receivables and trust investments	1,407,287	1,428,057
Cemetery property, at cost	1,458,945	1,451,666
Property and equipment, net	1,559,090	1,569,534
Non-current assets held for sale	120,999	122,626
Goodwill	1,227,624	1,198,153
Deferred charges and other assets	441,141	400,734
Cemetery perpetual care trust investments	863,284	905,744
	\$ 8,807,984	\$ 8,932,244
Liabilities & Stockholders Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 294,707	\$ 343,392
Current maturities of long-term debt	51,289	36,594
Current liabilities held for sale	201	149
Income taxes	262	46,305
Total current liabilities	346,459	426,440
Long-term debt	1,828,511	1,820,106
Deferred preneed funeral revenues	579,476	526,668
Deferred preneed cemetery revenues	765,275	753,876
Deferred income taxes	147,776	140,623
Non-current liabilities held for sale	89,654	91,928
Other liabilities	388,605	383,642
Non-controlling interest in funeral and cemetery trusts	2,334,152	2,390,288
Non-controlling interest in cemetery perpetual care trusts	871,667	906,590
Commitments and contingencies (Note 15)		
Stockholders equity:		

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Common stock, \$1 per share par value, 500,000,000 shares authorized, 257,164,644 and 262,858,169 issued and outstanding (net of 8,896,829 and 1,961,300 treasury shares, at par)	257,165	262,858
Capital in excess of par value	1,814,724	1,874,600
Accumulated deficit	(750,923)	(797,965)
Accumulated other comprehensive income	135,443	152,590
Total stockholders' equity	1,456,409	1,492,083
	\$ 8,807,984	\$ 8,932,244

(See notes to unaudited condensed consolidated financial statements)

SERVICE CORPORATION INTERNATIONAL

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)
(In thousands)

	Six months ended	
	June 30,	
	2008	2007
Cash flows from operating activities:		
Net income	\$ 72,916	\$ 52,760
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss (income) from discontinued operations, net of tax	362	(5,134)
Loss on early extinguishment of debt		14,480
Premiums paid on early extinguishment of debt		(11,368)
Depreciation and amortization	68,008	73,799
Amortization of cemetery property	16,526	17,800
Amortization of loan costs	1,863	3,617
Provision for doubtful accounts	3,915	6,688
Provision for deferred income taxes	28,079	38,024
Loss (gain) on divestitures and impairment charges, net	15,904	(2,063)
Share-based compensation	5,256	5,980
Excess tax benefits from share-based awards	(2,170)	(4,123)
Equity in earnings of unconsolidated subsidiaries		(6,270)
Change in assets and liabilities, net of effects from acquisitions and divestitures:		
Decrease (increase) in receivables	6,484	(5,222)
Increase in other assets	(10,069)	(12,196)
Decrease in payables and other liabilities	(128,320)	(40,626)
Effect of preneed funeral production and maturities:		
Decrease in preneed funeral receivables and trust investments	15,098	19,866
Increase in deferred preneed funeral revenue	20,836	18,656
Decrease in funeral non-controlling interest	(24,640)	(25,518)
Effect of cemetery production and deliveries:		
Decrease in preneed cemetery receivables and trust investments	24,206	30,452
Increase in deferred preneed cemetery revenue	20,421	24,218
Decrease in cemetery non-controlling interest	(17,578)	(19,215)
Other	(585)	(329)
Net cash provided by operating activities from continuing operations	116,512	174,276
Net cash provided by operating activities from discontinued operations		17,279
Net cash provided by operating activities	116,512	191,555
Cash flows from investing activities:		
Capital expenditures	(68,035)	(65,392)
Proceeds from divestitures and sales of property and equipment	12,831	214,494
Acquisitions	(7,871)	(212)
Net deposits of restricted funds and other	(21,477)	(238)
Net cash (used in) provided by investing activities from continuing operations	(84,552)	148,652

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Net cash provided by (used in) investing activities from discontinued operations	858	(8,546)
Net cash (used in) provided by investing activities	(83,694)	140,106
Cash flows from financing activities:		
Proceeds from the issuance of long-term debt	72,000	398,996
Debt issuance costs		(6,443)
Payments of debt	(54,367)	(2,152)
Principal payments on capital leases	(12,013)	(13,807)
Early extinguishment of debt		(422,641)
Purchase of Company common stock	(79,470)	(103,598)
Proceeds from exercise of stock options	3,596	13,189
Excess tax benefits from share-based awards	2,170	4,123
Payments of dividends	(20,879)	(17,645)
Bank overdrafts and other	(6,714)	2,211
Net cash used in financing activities from continuing operations	(95,677)	(147,767)
Net cash used in financing activities from discontinued operations		(2,113)
Net cash used in financing activities	(95,677)	(149,880)
Effect of foreign currency on cash and cash equivalents	(1,035)	1,124
Net (decrease) increase in cash and cash equivalents	(63,894)	182,905
Cash and cash equivalents at beginning of period	168,594	39,880
Cash and cash equivalents at end of period	\$ 104,700	\$ 222,785

(See notes to unaudited condensed consolidated financial statements)

SERVICE CORPORATION INTERNATIONAL

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(UNAUDITED)
(In thousands)

	Outstanding shares	Common stock	Treasury stock, par value	Capital in excess of par value	Accumulated deficit	Accumulated other comprehensive income	Total
Balance at December 31, 2007	262,858	\$ 264,819	\$ (1,961)	\$ 1,874,600	\$ (797,965)	\$ 152,590	\$ 1,492,083
Cumulative effect of accounting change					(3,265)		(3,265)
Net income					72,916		72,916
Dividends declared on common stock (\$.08 per share)				(20,581)			(20,581)
Other comprehensive loss						(17,147)	(17,147)
Employee share-based compensation earned				4,548			4,548
Stock option exercises	950	950		2,646			3,596
Restricted stock awards, net of forfeitures and other	363	293	70	346			709
Tax benefit related to share-based awards				3,020			3,020
Purchase of Company stock	(7,006)		(7,006)	(49,855)	(22,609)		(79,470)
Balance at June 30, 2008	257,165	\$ 266,062	\$ (8,897)	\$ 1,814,724	\$ (750,923)	\$ 135,443	\$ 1,456,409

(See notes to unaudited condensed consolidated financial statements)

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

1. Nature of Operations

We are a 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 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. 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, markers, casket and cremation memorialization products, 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 provided in the future.

We divested 70% of Kenyon International Emergency Services (Kenyon), a company that specializes in providing disaster management services in mass fatality incidents, in the fourth quarter of 2007. Kenyon's results are included in our funeral operations segment through the date of the sale. As part of the Alderwoods transaction, we acquired an insurance business that we sold in the third quarter of 2007. The operations of this business through the date of sale are presented as discontinued operations in our condensed consolidated statement of operations.

2. Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

Our condensed consolidated financial statements include the accounts of Service Corporation International and all wholly-owned subsidiaries. These financial statements also include the accounts of the funeral trusts, cemetery merchandise and services trusts, and cemetery perpetual care trusts in which we have a variable interest and are the primary beneficiary. The 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 presentation of the results for these periods. These 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, 2007, 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 and Prior Period Items

Certain reclassifications have been made to prior period amounts to conform to the current period financial statement presentation with no effect on our previously reported results of operations, financial condition, or cash flows.

In connection with our ongoing efforts to remediate our previously reported material weaknesses and other internal control deficiencies, we recorded several immaterial adjustments related to prior accounting periods during the three months ended June 30, 2008. These adjustments were not quantitatively or qualitatively material to our condensed consolidated financial statements for the three or six months ended June 30, 2008, nor were such items quantitatively or qualitatively material to any of our prior annual or quarterly financial statements. The net impact of these adjustments was an increase to our pre-tax income in the amount of \$3.4 million for the three months ended June 30, 2008. These adjustments had no impact on our consolidated or segment gross profit for the three months ended June 30, 2008.

Use of Estimates in the Preparation of Financial Statements

The preparation of the 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 Form 10-K for the year ended December 31, 2007. 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 condensed consolidated financial statements and the reported amounts of expenses during the reporting period. As a result, actual results could differ from these estimates.

3. Recently Issued Accounting Standards

Determination of the Useful Life of Intangible Assets

In April 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position Statement of Financial Accounting Standards (SFAS) No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, *Goodwill and Other Intangible Assets* and requires enhanced related disclosures. FSP 142-3 must be applied prospectively to all intangible assets acquired as of and subsequent to fiscal years beginning after December 15, 2008. We are currently evaluating the impact of adopting FSP 142-3 on our consolidated financial statements.

Derivative Instruments and Hedging Activities

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - An Amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 amends and expands the disclosures required by SFAS 133 to provide an enhanced understanding of the reasons an entity engages in derivative instruments and hedging activities. It also requires disclosures about how such items are accounted for under SFAS 133 and how they impact the entity's financial statements. The provisions of SFAS 161 are effective for us beginning January 1, 2009. The adoption of this statement is not expected to have a material impact on our consolidated financial statements.

Business Combinations

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141(R)), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired (including goodwill), the liabilities assumed and any non-controlling interest in the acquiree. SFAS 141(R) also establishes disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The provisions of SFAS 141(R) are effective for us for business combinations for which the acquisition date is on or after January 1, 2009, with the exception of certain income tax effects related to our prior business combinations, which will be accounted for pursuant to the provisions of SFAS 141(R). The impact of adopting SFAS 141(R) will be dependent on future business combinations, if any, that we may pursue after its effective date.

Non-controlling Interests

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51* (SFAS 160), which establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as an unconsolidated investment, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. The provisions of SFAS 160 are effective for us on January 1, 2009. We are currently evaluating the impact of adopting SFAS 160 on our consolidated financial statements.

Split-Dollar Life Insurance Agreements

In March 2007, the FASB ratified the consensus reached by the Emerging Issues Task Force (EITF) on Issue No. 06-10 *Accounting for Collateral Assignment Split-Dollar Life Insurance Agreements* (EITF 06-10). EITF 06-10 provides guidance for determining the liability for the postretirement benefit obligation as well as recognition and measurement of the associated asset on the basis of the terms of a collateral assignment agreement. We adopted the provisions of EITF 06-10 effective January 1, 2008. As a result of our adoption, we recorded a \$3.3 million cumulative-effect adjustment which increased our *Accumulated deficit* as of January 1, 2008.

Fair Value Option

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure various financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are

reported in earnings. The fair value option may be elected on an instrument-by-instrument basis, as long as it is applied to the instrument in its entirety. The election is irrevocable, unless an event specified in SFAS 159 occurs that results in a new election date. We adopted the provisions of SFAS 159 effective January 1, 2008. The adoption of SFAS 159 had no impact on our consolidated financial statements as we elected not to measure any additional financial instruments at fair value as of the date of adoption.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). The statement defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, establishes a framework for measuring fair value, and expands disclosures about instruments measured at fair value. SFAS 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets;

Level 2 inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument;

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

An asset's or liability's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* (FSP 157-1) and FSP No. FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2). FSP 157-1 amends SFAS 157 to exclude SFAS No. 13, *Accounting for Leases* and its related accounting pronouncements that address leasing transactions. FSP 157-2 provides a one-year deferral of the effective date of SFAS 157 for non-financial assets and liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. In accordance with FSP 157-2, we adopted the provisions of SFAS 157 for our financial assets and liabilities that are measured on a recurring basis at fair value, effective January 1, 2008. These financial assets include the investments of our funeral, cemetery, and cemetery perpetual care trusts. For additional disclosures required by SFAS 157 for these assets, see Notes 4 through 6 to our condensed consolidated financial statements.

The provisions of SFAS 157 have not been applied to our non-financial assets and liabilities. The major categories of assets and liabilities that are subject to non-recurring fair value measurement, for which we have not yet applied the provisions of SFAS 157, are as follows: reporting units measured at fair value in the first step of a goodwill impairment test under SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142); indefinite-lived intangible assets measured at fair value for impairment assessment under SFAS 142; non-financial assets measured at fair value for an impairment assessment under SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, and non-financial assets and liabilities initially measured at fair value in a business combination under SFAS No. 141, *Business Combinations*.

4. Preneed Funeral Activities

Preneed funeral receivables and trust investments, net of allowance for cancellation, represent trust investments, including investment earnings, and customer receivables, net of unearned finance charges, related to unperformed, price-guaranteed preneed funeral contracts. When we, as the primary beneficiary, 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 *Non-controlling interest in funeral and cemetery trusts*. Amounts are withdrawn from the trusts after the contract obligations are performed. We deposited \$23.9 million and \$27.4 million into and withdrew \$31.6 million and \$39.2 million from the trusts during the three months ended June 30, 2008 and 2007, respectively. We deposited \$44.8 million and \$45.4 million into and withdrew \$70.5 million and \$74.2 million from the trusts during the six months ended June 30, 2008 and 2007, respectively. Cash flows from preneed funeral contracts are presented as operating cash flows in our condensed consolidated statement of cash flows.

The components of *Preneed funeral receivables and trust investments* in our condensed consolidated balance sheet at June 30, 2008 and December 31, 2007 are as follows:

	June 30, 2008	December 31, 2007
	(In thousands)	
Trust investments, at market	\$ 830,783	\$ 848,195
Cash and cash equivalents	150,952	194,728
Insurance-backed fixed income securities	214,986	201,258
Receivables from customers	236,684	225,905
Unearned finance charge	(6,219)	(5,961)
	1,427,186	1,464,125
Allowance for cancellation	(28,683)	(29,722)
Preneed funeral receivables and trust investments	\$ 1,398,503	\$ 1,434,403

The cost and market values associated with funeral trust investments recorded at fair market value at June 30, 2008 and December 31, 2007 are detailed below. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds, and private equity investments. Fair market value represents the value of the underlying securities and cash held by the common trust funds, mutual funds at published values, and the estimated market 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). The fair market value of such funeral trust investments, in the aggregate, was 95% and 101% of the related cost basis of such investments as of June 30, 2008 and December 31, 2007, respectively.

	June 30, 2008			
	Cost	Unrealized gains	Unrealized losses	Fair market value
	(In thousands)			
Fixed income securities:				
U.S. Treasury	\$ 54,096	\$ 439	\$ (3,365)	\$ 51,170
Foreign government	99,347	539	(503)	99,383
Corporate	21,938	118	(402)	21,654
Mortgage-backed	18,315	172	(1,299)	17,188
Asset-backed	20			20
Equity securities:				
Preferred stock	1,354	11	(103)	1,262
Common stock	363,168	7,635	(26,619)	344,184
Mutual funds:				
Equity	125,127	1,413	(9,872)	116,668
Fixed income	147,096	2,150	(8,468)	140,778
Private equity and other	53,439	2,244	(8,603)	47,080
Trust investments	\$ 883,900	\$ 14,721	\$ (59,234)	\$ 839,387
Less: Assets associated with businesses held for sale				(8,604)
				\$ 830,783

	December 31, 2007			
	Cost	Unrealized gains	Unrealized losses	Fair market value
	(In thousands)			
Fixed income securities:				
U.S. Treasury	\$ 79,430	\$ 630	\$ (378)	\$ 79,682
Foreign government	60,330	344	(440)	60,234
Corporate	14,937	206	(233)	14,910
Mortgage-backed	2,670	53	(17)	2,706
Asset-backed	33			33
Equity securities:				
Preferred stock	1,581	36	(23)	1,594
Common stock	378,628	12,415	(6,131)	384,912
Mutual funds:				
Equity	127,606	3,991	(2,246)	129,351
Fixed income	140,857	3,005	(1,612)	142,250
Private equity and other	43,820	2,815	(5,297)	41,338
Trust investments	\$ 849,892	\$ 23,495	\$ (16,377)	\$ 857,010
Less: Assets associated with businesses held for sale				(8,815)
				\$ 848,195

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 provided in SFAS 157. Our investments classified as Level 1 securities include common stock and mutual funds.

Where quoted market prices are not available for the specific security, then fair values are estimated by using either quoted prices of securities with similar characteristics or a 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 securities are United States (U.S.) Treasury, foreign government, corporate, mortgage-backed and asset-backed fixed income securities, and preferred stock equity securities, all of which are classified within Level 2 of the SFAS 157 valuation hierarchy.

The valuation of private equity and other investments requires significant 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. Private equity investments are valued using market appraisals or a discounted cash flow methodology depending on the nature of the underlying assets. The appraisals assess value based on a combination of replacement cost, comparative sales analysis, and discounted cash flow analysis. As a result of the adoption of SFAS 157 in the first quarter of 2008, we recorded a \$3.5 million decrease in the fair value of our private equity investments held by the funeral trusts to reflect time-based restrictions on the exit from the investments. Such private equity and other investments are included within Level 3 of the SFAS 157 valuation hierarchy.

The inputs into the fair value of our market-based funeral trust investments are categorized as follows:

June 30, 2008

	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Fair market value
Trust investments	\$601,630	\$ 190,677	\$ 47,080	\$839,387
	12			

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

Fair market value, January 1, 2008	\$ 37,865
Total realized and unrealized gains included in other comprehensive income (a)	9,249
Purchases, sales, contributions, and distributions, net	(34)
Fair market value, June 30, 2008	\$ 47,080

(a) All gains (losses) recognized in other comprehensive income for funeral trust investments are attributable to non-controlling interest holders and are offset by a corresponding increase (decrease) in *Non-controlling interest in funeral and cemetery trusts*. See Note 7 to the condensed consolidated financial statements for further information related to our non-controlling interest in funeral trust investments.

Maturity dates of the fixed income securities included in trust investments, at market, range from 2008 to 2038. Maturities of fixed income securities included in trust investments, at market, at June 30, 2008 are estimated as follows:

	Market (In thousands)
Due in one year or less	\$ 71,772
Due in one to five years	50,693
Due in five to ten years	40,243
Thereafter	26,707
	\$ 189,415

During the three months ended June 30, 2008, purchases and sales of available-for-sale securities included in trust investments were \$55.1 million and \$134.1 million, respectively. These sale transactions resulted in \$9.5 million and \$11.9 million of realized gains and realized losses, respectively, for the three months ended June 30, 2008. During the three months ended June 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$84.5 million and \$127.5 million, respectively. These sale transactions resulted in \$23.3 million and \$5.7 million of realized gains and realized losses, respectively, for the three months ended June 30, 2007.

During the six months ended June 30, 2008, purchases and sales of available-for-sale securities included in trust investments were \$190.4 million and \$234.8 million, respectively. These sale transactions resulted in \$30.3 million and \$26.9 million of realized gains and realized losses, respectively, for the six months ended June 30, 2008. During the six months ended June 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$311.9 million and \$195.5 million, respectively. These sale transactions resulted in \$32.8 million and \$12.1 million of realized gains and realized losses, respectively, for the six months ended June 30, 2007.

Earnings from all trust investments are recognized in current funeral revenues when a service is performed, merchandise is delivered, or upon cancellation of the funeral contract. Only the amount we are entitled to retain is recognized when a contract is cancelled. Recognized earnings (realized and unrealized) related to these trust investments were \$9.9 million and \$10.8 million for the three months ended June 30, 2008 and 2007, respectively. Recognized earnings (realized and unrealized) related to these trust investments were \$21.1 million and \$22.1 million for the six months ended June 30, 2008 and 2007, respectively.

We assess our trust investments for other-than-temporary declines in fair value on a quarterly basis. Impairment charges, if any, as a result of this assessment are recognized as investment losses and offset by interest income related to non-controlling interest in funeral trust investments in *Other income, net* in our condensed consolidated statement of operations. As a result of our most recent review at June 30, 2008, we recorded no impairment charges. As a result of our reviews during 2007, we recorded a \$3.5 million impairment charge for other-than-temporary declines in fair value related to unrealized losses on certain private equity and other investments. See Note 7 to the condensed consolidated financial statements for further information related to our non-controlling interest in funeral trust investments.

5. Preneed Cemetery Activities

Preneed cemetery receivables and trust investments, net of allowance for cancellation, represent trust investments, including investment earnings, and customer receivables, net of unearned finance charges, for contracts sold in advance of when the property interment rights, merchandise, or services are needed. When we, as the primary beneficiary, receive payments from the customer, we

deposit the amount required by law into the trust and reclassify the corresponding amount from *Deferred preneed cemetery revenues*, and record the amount into *Non-controlling interest in funeral and cemetery trusts*. Amounts are withdrawn from the trusts when the contract obligations are performed. We deposited \$30.0 million and \$30.6 million into and withdrew \$41.5 million and \$44.2 million from the trusts during the three months ended June 30, 2008 and 2007, respectively. We deposited \$55.3 million and \$59.2 million into and withdrew \$72.7 million and \$81.2 million from the trusts during the six months ended June 30, 2008 and 2007, respectively. Cash flows from preneed cemetery contracts are presented as operating cash flows in our condensed consolidated statement of cash flows.

The components of *Preneed cemetery receivables and trust investments* in the condensed consolidated balance sheet at June 30, 2008 and December 31, 2007 are as follows:

	June 30, 2008	December 31, 2007
	(In thousands)	
Trust investments, at market	\$ 982,863	\$ 759,215
Cash and cash equivalents	155,667	399,301
Receivables from customers	350,406	351,409
Unearned finance charges	(48,780)	(47,527)
	1,440,156	1,462,398
Allowance for cancellation	(32,869)	(34,341)
Preneed cemetery receivables and trust investments	\$ 1,407,287	\$ 1,428,057

The cost and market values associated with the cemetery merchandise and service trust investments recorded at fair market value at June 30, 2008 and December 31, 2007 are detailed below. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds, and private equity investments. Fair market value represents the value of the underlying securities and cash held by the common trust funds, mutual funds at published values, and the estimated market 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). The fair market value of such cemetery trust investments, in the aggregate, was 97% and 104% of the related cost basis of such investments as of June 30, 2008 and December 31, 2007, respectively.

	June 30, 2008			
	Cost	Unrealized gains	Unrealized losses	Fair market value
	(In thousands)			
Fixed income securities:				
U.S. Treasury	\$ 46,049	\$ 426	\$ (1,892)	\$ 44,583
Foreign government	15,375	247	(87)	15,535
Corporate	17,207	161	(293)	17,075
Mortgage-backed	14,275	133	(587)	13,821
Equity securities:				
Preferred stock	2,627	24	(108)	2,543
Common stock	508,467	6,996	(22,079)	493,384
Mutual funds:				
Equity	259,433	5,169	(13,248)	251,354
Fixed income	182,162	4,152	(6,539)	179,775
Private equity and other	27,623	1,286	(4,654)	24,255

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Trust investments	\$ 1,073,218	\$ 18,594	\$ (49,487)	\$ 1,042,325
Less: Assets associated with businesses held for sale				(59,462)
				\$ 982,863

	December 31, 2007			Fair market value
	Cost	Unrealized gains	Unrealized losses	
	(In thousands)			
Fixed income securities:				
U.S. Treasury	\$ 19,371	\$ 899	\$ (205)	\$ 20,065
Foreign government	14,016	296		14,312
Corporate	17,297	452	(90)	17,659
Equity securities:				
Preferred stock	2,979	144	(33)	3,090
Common stock	402,028	20,923	(5,956)	416,995
Mutual funds:				
Equity	182,214	12,905	(2,861)	192,258
Fixed income	126,728	5,535	(1,185)	131,078
Private equity and other	26,124	2,103	(3,493)	24,734
Trust investments	\$ 790,757	\$ 43,257	\$ (13,823)	\$ 820,191
Less: Assets associated with businesses held for sale				(60,976)
				\$ 759,215

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 provided in SFAS 157. Our investments classified as Level 1 securities include common stock and mutual funds.

Where quoted market prices are not available for the specific security, then fair values are estimated by using either quoted prices of securities with similar characteristics or a 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 securities are U.S. Treasury, foreign government, corporate, mortgage-backed and asset-backed fixed income securities, and preferred stock equity securities, all of which are classified within Level 2 of the SFAS 157 valuation hierarchy.

The valuation of private equity and other investments requires significant 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 appraisals. Our private equity investments are valued using market appraisals or a discounted cash flow methodology depending on the nature of the underlying assets. The appraisals assess value based on a combination of replacement cost, comparative sales analysis, and discounted cash flow analysis. As a result of the adoption of SFAS 157 in the first quarter of 2008, we recorded a \$2.9 million decrease in the fair value of our private equity investments held by the cemetery merchandise and service trusts to reflect time-based restrictions on the exit from the investments. Such private equity and other investments are included within Level 3 of the SFAS 157 valuation hierarchy.

The inputs into the fair value of our market-based cemetery trust investments are categorized as follows:

	June 30, 2008			Fair market value
	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
	(In thousands)			
Trust investments	\$924,513	\$93,557	\$ 24,255	\$1,042,325

The change in market-based cemetery trust investments with significant unobservable inputs (Level 3) is as follows (in thousands):

Fair market value, January 1, 2008	\$ 21,809
Total realized and unrealized gains included in other comprehensive income (a)	3,711
Purchases, sales, contributions, and distributions, net	(1,265)
Fair market value, June 30, 2008	\$ 24,255

(a) All gains (losses) recognized in other comprehensive income for cemetery trust investments are attributable to

non-controlling interest holders and are offset by a corresponding increase (decrease) in *Non-controlling interest in funeral and cemetery trusts*. See Note 7 to the condensed consolidated financial statements for further information related to our non-controlling interest in cemetery trust investments.

Maturity dates of the fixed income securities range from 2008 to 2038. Maturities of fixed income securities at June 30, 2008 are estimated as follows:

	Market (In thousands)
Due in one year or less	\$ 1,929
Due in one to five years	32,925
Due in five to ten years	27,925
Thereafter	28,235
	\$ 91,014

During the three months ended June 30, 2008, purchases and sales of available-for-sale securities included in trust investments were \$69.4 million and \$143.0 million, respectively. These sale transactions resulted in \$11.9 million and \$13.3 million of realized gains and realized losses, respectively, for the three months ended June 30, 2008. During the three months ended June 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$112.7 million and \$94.8 million, respectively. These sale transactions resulted in \$23.0 million and \$5.5 million of realized gains and realized losses, respectively, for the three months ended June 30, 2007.

During the six months ended June 30, 2008, purchases and sales of available-for-sale securities included in trust investments were \$634.7 million and \$247.3 million, respectively. These sale transactions resulted in \$23.4 million and \$29.8 million of realized gains and realized losses, respectively, for the six months ended June 30, 2008. During the six months ended June 30, 2007, purchases and sales of available-for-sale securities included in trust investments were \$357.0 million and \$203.6 million, respectively. These sale transactions resulted in \$36.3 million and \$12.4 million of realized gains and realized losses, respectively, for the six months ended June 30, 2007.

Earnings from all trust investments are recognized in current cemetery revenues when the service is performed, the merchandise is delivered, or upon cancellation of the cemetery contract. Only the amount we are entitled to retain is recognized when a contract is cancelled. Recognized earnings (realized and unrealized) related to these trust investments were \$5.1 million and \$5.2 million for the three months ended June 30, 2008 and 2007, respectively. Recognized earnings (realized and unrealized) related to these trust investments were \$9.6 million and \$9.8 million for the six months ended June 30, 2008 and 2007, respectively.

We assess our trust investments for other-than-temporary declines in fair value on a quarterly basis. Impairment charges, if any, as a result of this assessment are recognized as investment losses and offset by interest income related to non-controlling interest in cemetery trust investments in *Other income, net* in our condensed consolidated statement of operations. As a result of our most recent review at June 30, 2008, we recorded no impairment charges. As a result of our reviews during 2007, we recorded a \$3.2 million impairment charge for other-than-temporary declines in fair value related to unrealized losses on certain private equity and other investments. See Note 7 to the condensed consolidated financial statements for further information related to our non-controlling interest in cemetery trust investments.

6. Cemetery Perpetual Care Trusts

We are required by state or provincial law to pay into cemetery perpetual care trusts a portion of the proceeds from the sale of cemetery property interment rights. As the primary beneficiary of the trusts, we consolidate the cemetery perpetual care trust investments with a corresponding amount recorded as *Non-controlling interest in cemetery perpetual care trusts*. We deposited \$6.1 million and \$10.5 million into the trusts and withdrew \$9.3 million and \$10.3 million from the trusts during the three months ended June 30, 2008 and 2007, respectively. We deposited \$11.9 million and \$14.6 million into the trusts and withdrew \$14.5 million and \$18.7 million from the trusts during the six months ended June 30, 2008 and 2007, respectively. Cash flows from cemetery perpetual care contracts are presented as operating cash flows in our condensed consolidated statement of cash flows.

The components of *Cemetery perpetual care trust investments* in the condensed consolidated balance sheet at June 30, 2008 and December 31, 2007 are as follows:

	June 30, 2008	December 31, 2007
	(In thousands)	
Trust investments, at market	\$ 791,686	\$ 817,228
Cash and cash equivalents	71,598	88,516
Cemetery perpetual care trust investments	\$ 863,284	\$ 905,744

The cost and market values associated with market-based trust investments held in cemetery perpetual care trusts recorded at fair market value at June 30, 2008 and December 31, 2007 are detailed below. Cost reflects the investment (net of redemptions) of control holders in common trust funds, mutual funds, and private equity investments. Fair

market value represents the value of the underlying securities and cash held by the common trust funds, mutual funds at published values, and the estimated market 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). The fair market value of such cemetery perpetual care trust investments, in the aggregate, was 94% and 100% of the related cost basis of such investments as of June 30, 2008 and December 31, 2007, respectively.

	June 30, 2008			Fair market value
	Cost	Unrealized gains	Unrealized losses	
	(In thousands)			
Fixed income securities:				
U.S. Treasury	\$ 5,313	\$ 762	\$ (252)	\$ 5,823
Foreign government	24,568	370	(152)	24,786
Corporate	41,916	154	(1,919)	40,151
Mortgage-backed	3,889	7	(265)	3,631
Equity securities:				
Preferred stock	5,166	2	(381)	4,787
Common stock	120,031	3,171	(8,695)	114,507
Mutual funds:				
Equity	52,535	154	(4,203)	48,486
Fixed income	572,506	254	(40,157)	532,603
Private equity and other	35,937	1,862	(4,480)	33,319
Cemetery perpetual care trust investments	\$ 861,861	\$ 6,736	\$ (60,504)	\$ 808,093
Less: Assets associated with businesses held for sale				(16,407)
				\$ 791,686

	December 31, 2007			Fair market value
	Cost	Unrealized gains	Unrealized losses	
	(In thousands)			
Fixed income securities:				
U.S. Treasury	\$ 2,647	\$ 703	\$ (1)	\$ 3,349
Foreign government	25,065	789	(13)	25,841
Corporate	42,437	225	(555)	42,107
Mortgage-backed	348	7		355
Equity securities:				
Preferred stock	2,403	13	(58)	2,358
Common stock	128,815	3,501	(2,840)	129,476
Mutual funds:				
Equity	44,221	1,208	(1,003)	44,426
Fixed income	555,509	3,256	(10,714)	548,051
Private equity and other	34,894	3,145	(542)	37,497
Cemetery perpetual care trust investments	\$ 836,339	\$ 12,847	\$ (15,726)	\$ 833,460
				(16,232)

Less: Assets associated with businesses held for sale

\$ 817,228

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 provided in SFAS 157. Our investments classified as Level 1 securities include common stock and mutual funds.

Where quoted market prices are not available for the specific security, then fair values are estimated by using either quoted prices of securities with similar characteristics or a fair value model with observable inputs that include a combination of interest rates, yield curves, credit risks, prepayment speeds, rating, and tax exempt status. Examples of such securities are U.S. Treasury, foreign government, corporate, mortgage-backed and asset-backed fixed income securities, and preferred stock equity securities, all of which are classified within Level 2 of the SFAS 157 valuation hierarchy.

The valuation of private equity and other investments requires significant 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 appraisals. Our private equity investments are valued using market appraisals or a discounted cash flow methodology depending on the nature of the underlying assets. The appraisals assess value based on a combination of replacement cost, comparative sales analysis, and discounted cash flow analysis. As a result of the adoption of SFAS 157 in the first quarter of 2008, we

recorded a \$4.9 million decrease in the fair value of our private equity investments held by the cemetery perpetual care trusts to reflect time-based restrictions on the exit from the investments. Such private equity and other investments are included within Level 3 of the SFAS 157 valuation hierarchy.

The inputs into the fair value of our market-based cemetery perpetual care trust investments are categorized as follows:

	June 30, 2008			
	Quoted market prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Fair market value
	(In thousands)			
Trust investments	\$695,596	\$79,178	\$ 33,319	\$808,093

The change in market-based cemetery perpetual care trust investments with significant unobservable inputs (Level 3) is as follows (in thousands):

Fair market value, January 1, 2008	\$ 32,644
Total realized and unrealized gains included in other comprehensive income (a)	5,101
Purchases, sales, contributions, and distributions, net	(4,426)
Fair market value, June 30, 2008	\$ 33,319

(a) All gains (losses) recognized in other comprehensive income for cemetery perpetual care trust investments are attributable to non-controlling interest holders and are offset by a corresponding increase (decrease) in *Non-controlling interest in cemetery perpetual care trusts*. See Note 7 to the condensed consolidated financial statements for further information related to our non-controlling interest in cemetery perpetual care trust investments.

Maturity dates of the fixed income securities range from 2008 to 2038. Maturities of fixed income securities at June 30, 2008 are estimated as follows:

	Market (In thousands)
Due in one year or less	\$ 2,704
Due in one to five years	38,976
Due in five to ten years	13,465
Thereafter	19,246
	\$ 74,391

During the three months ended June 30, 2008, purchases and sales of available-for-sale securities in the cemetery perpetual care trusts were \$58.3 million and \$64.5 million, respectively. These sale transactions resulted in \$0.9 million and \$0.6 million of realized gains and realized losses, respectively. During the three months ended June 30, 2007, purchases and sales of available-for-sale securities in the cemetery perpetual care trusts were \$58.6 million and \$51.7 million, respectively. These sales transactions resulted in \$18.9 million and \$5.0 million of

realized gains and realized losses, respectively.

During the six months ended June 30, 2008, purchases and sales of available-for-sale securities in the cemetery perpetual care trusts were \$117.1 million and \$125.9 million, respectively. These sale transactions resulted in \$10.4 million and \$13.6 million of realized gains and realized losses, respectively. During the six months ended June 30, 2007, purchases and sales of available-for-sale securities in the cemetery perpetual care trusts were \$227.3 million and \$94.1 million, respectively. These sales transactions resulted in \$24.4 million and \$6.2 million of realized gains and realized losses, respectively.

Distributable earnings from these cemetery perpetual care trust investments are recognized in current cemetery revenues to the extent we incur qualifying cemetery maintenance costs. Recognized earnings related to these cemetery perpetual care trust investments were \$10.2 million and \$13.0 million for the three months ended June 30, 2008 and 2007, respectively. Recognized earnings related to these cemetery perpetual care trust investments were \$20.0 million and \$25.3 million for the six months ended June 30, 2008 and 2007, respectively.

We assess our trust investments for other-than-temporary declines in fair value on a quarterly basis. Impairment charges, if any, as a result of this assessment are recognized as investment losses and offset by interest income related to non-controlling interest in

cemetery perpetual care trust investments in *Other income, net* in our condensed consolidated statement of operations. As a result of our most recent review at June 30, 2008, we recorded no impairment charges. As a result of our reviews during 2007, we recorded a \$1.2 million impairment charge for other-than-temporary declines in fair value related to unrealized losses on certain private equity and other investments. See Note 7 to the condensed consolidated financial statements for further information related to our non-controlling interest in cemetery perpetual care trust investments.

7. Non-Controlling Interest in Funeral and Cemetery Trusts and in Cemetery Perpetual Care Trusts

We consolidate in our balance sheet the merchandise and service trusts associated with our preneed funeral and cemetery activities in accordance with FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities (revised December 2003 an interpretation of ARB No. 51 (FIN 46R))*. Although FIN 46R requires the consolidation of the merchandise and service trusts, it does not change the legal relationships among the trusts, us, or our customers. The customers are the legal beneficiaries of these merchandise and service trusts, and therefore, their interests in these trusts represent a non-controlling interest in subsidiaries.

The components of *Non-controlling interest in funeral and cemetery trusts* and *Non-controlling interest in cemetery perpetual care trusts* in our condensed consolidated balance sheet at June 30, 2008 and December 31, 2007 are detailed below.

	Preneed funeral	June 30, 2008 Preneed		June 30, 2008 Cemetery perpetual care
		cemetery	Total	
		(In thousands)		
Trust investments, at market value	\$ 830,783	\$ 982,863	\$ 1,813,646	\$ 791,686
Cash and cash equivalents	150,952	155,667	306,619	71,598
Insurance-backed fixed income securities	214,986		214,986	
Accrued trust operating asset (payable), deferred taxes, and other	1,452	(2,551)	(1,099)	8,383
Non-controlling interest	\$ 1,198,173	\$ 1,135,979	\$ 2,334,152	\$ 871,667

	Preneed funeral	December 31, 2007 Preneed		December 31, 2007 Cemetery perpetual care
		cemetery	Total	
		(In thousands)		
Trust investments, at market value	\$ 848,195	\$ 759,215	\$ 1,607,410	\$ 817,228
Cash and cash equivalents	194,728	399,301	594,029	88,516
Insurance-backed fixed income securities	201,258		201,258	
Accrued trust operating payables, deferred taxes, and other	(3,737)	(8,672)	(12,409)	846
Non-controlling interest	\$ 1,240,444	\$ 1,149,844	\$ 2,390,288	\$ 906,590

Other Income, Net

The components of *Other income, net* in our condensed consolidated statement of operations for the three and six months ended June 30, 2008 and 2007 are detailed below. See Notes 4 through 6 to the condensed consolidated financial statements for further discussion of the amounts related to the funeral, cemetery, and cemetery perpetual care trusts.

Three months ended June 30, 2008

	Funeral	Cemetery	Cemetery perpetual	Other, net	Total
	trusts	trusts	care trusts (In thousands)		
Realized gains	\$ 9,510	\$ 11,959	\$ 865	\$	\$ 22,334
Realized losses	(11,892)	(13,320)	(638)		(25,850)
Interest, dividend, and other ordinary income	14,902	12,502	9,990		37,394
Trust expenses and income taxes	(4,408)	(10,972)	(2,386)		(17,766)
Net trust investment income	8,112	169	7,831		16,112
Interest expense related to non-controlling interest in funeral and cemetery trust investments	(8,112)	(169)			(8,281)
Interest expense related to non-controlling interest in cemetery perpetual care trust investments			(7,831)		(7,831)
Total non-controlling expense	(8,112)	(169)	(7,831)		(16,112)
Other income, net				1,945	1,945
Total other income, net	\$	\$	\$	\$ 1,945	\$ 1,945

Six months ended June 30, 2008

	Funeral	Cemetery	Cemetery perpetual	Other, net	Total
	trusts	trusts	care trusts (In thousands)		
Realized gains	\$ 30,309	\$ 23,414	\$ 10,352	\$	\$ 64,075
Realized losses (1)	(26,890)	(29,811)	(13,631)		(70,332)
Interest, dividend, and other ordinary income	20,287	16,738	18,376		55,401
Trust expenses and income taxes	(9,071)	(15,394)	(2,922)		(27,387)
Net trust investment income (losses)	14,635	(5,053)	12,175		21,757
Interest (expense) income related to non-controlling interest in funeral and cemetery trust investments	(14,635)	5,053			(9,582)
Interest expense related to non-controlling interest in cemetery perpetual care trust investments			(12,175)		(12,175)
Total non-controlling interest (expense) income	(14,635)	5,053	(12,175)		(21,757)
Other income, net				3,117	3,117
Total other income, net	\$	\$	\$	\$ 3,117	\$ 3,117

Three months ended June 30, 2007

	Funeral	Cemetery	Cemetery perpetual	Other, net	Total
	trusts	trusts	care trusts (In thousands)		
Realized gains	\$ 23,236	\$ 23,043	\$ 18,924	\$	\$ 65,203
Realized losses (1)	(9,226)	(8,766)	(6,162)		(24,154)
Interest, dividend, and other ordinary income	6,540	7,085	12,371		25,996
Trust expenses and income taxes	(2,331)	(4,869)	(1,393)		(8,593)
Net trust investment income	18,219	16,493	23,740		58,452
Interest expense related to non-controlling interest in funeral and cemetery trust investments	(18,219)	(16,493)			(34,712)
Interest expense related to non-controlling interest in cemetery perpetual care trust investments			(23,740)		(23,740)

Total non-controlling interest expense	(18,219)	(16,493)	(23,740)		(58,452)
Other income, net				1,755	1,755
Total other income, net	\$	\$	\$	\$ 1,755	\$ 1,755

Six months ended June 30, 2007

	Funeral trusts	Cemetery trusts	Cemetery perpetual care trusts (In thousands)	Other, net	Total
Realized gains	\$ 32,751	\$ 36,337	\$ 24,432	\$	\$ 93,520
Realized losses (1)	(15,637)	(15,619)	(7,383)		(38,639)
Interest, dividend, and other ordinary income	11,651	14,693	22,319		48,663
Trust expenses and income taxes	(5,379)	(8,391)	(2,387)		(16,157)
Net trust investment income	23,386	27,020	36,981		87,387
Interest expense related to non-controlling interest in funeral and cemetery trust investments	(23,386)	(27,020)			(50,406)
Interest expense related to non-controlling interest in cemetery perpetual care trust investments			(36,981)		(36,981)
Total non-controlling interest expense	(23,386)	(27,020)	(36,981)		(87,387)
Other expense, net				1,138	1,138
Total other income, net	\$	\$	\$	\$ 1,138	\$ 1,138

(1) Realized losses include impairment charges for other-than-temporary declines in fair value of \$3.5 million for funeral trusts, \$3.2 million for cemetery trusts, and \$1.2 million for cemetery perpetual care trusts. See Notes 4 through 6 for additional information.

8. Income Taxes

Income tax expense during interim periods is based on the estimated annual effective income tax rate plus any discrete items which are recorded in the period that the specific item occurs. Discrete items include such events as accrual true-ups to tax returns, tax audit settlements, and other infrequently occurring or unusual events occurring in a given quarter. For the three months ended June 30, 2008, income tax expense was approximately 39% of pre-tax income and for the six months ended June 30, 2008, income tax expense was approximately 38% of pretax income. Variances in our estimated annual effective tax rate from the 35% federal statutory rate primarily result from the effect of discrete adjustments, state and Canadian income taxes and estimated permanent differences. Specific items which affected income tax expense for the six months ended June 30, 2008 included a return to accrual adjustment on our 2007 Canadian income tax returns which were filed during the second -quarter, accrued interest on contingent tax liabilities recorded under FIN 48, and permanent differences between the book basis and tax basis of asset dispositions.

At June 30, 2008 we had approximately \$148 million of gross unrecognized tax benefits. If all unrecognized benefits were recognized, approximately \$41 million would impact our effective tax rate in future periods. Both of the amounts have increased over the corresponding amount that existed at December 31, 2007 as a result of accrual of interest and penalties associated with our unrecognized tax benefits noted above.

We file numerous US federal, state and foreign income tax returns. A number of years may elapse before particular tax matters, for which we have unrecognized tax benefits, are audited and finally settled. In the United States, the Internal Revenue Service has recently completed its field work for tax years 1999 through 2002 and is currently auditing tax years 2003 through 2005. Various state and foreign jurisdictions are auditing years through 2005. It is reasonably possible that one or more of the multi-jurisdictional audits will be settled by December 31, 2008 and if favorably resolved could result in a significant reduction in the amount of our unrecognized tax benefits.

9. Debt

Debt as of June 30, 2008 and December 31, 2007 was as follows:

	June 30, 2008	December 31, 2007
	(In thousands)	
6.5% notes due March 2008	\$	\$ 45,209
7.7% notes due April 2009	28,731	28,731
7.875% debentures due February 2013	55,627	55,627
7.375% senior notes due October 2014	250,000	250,000
6.75% notes due April 2015	200,000	200,000
6.75% notes due April 2016	250,000	250,000
7.0% notes due June 2017	300,000	300,000
7.625% senior notes due October 2018	250,000	250,000
7.5% notes due April 2027	200,000	200,000
Revolving credit facility due November 2011	45,000	
Series B senior notes due November 2011	150,000	150,000
Convertible debentures, maturities through 2013, fixed interest rates at 5.00% conversion prices from \$13.02 to \$50.00 per share	4,175	4,175
Obligations under capital leases	112,574	112,507
Mortgage notes and other debt, maturities through 2050	38,631	15,742
Unamortized pricing discounts and other	(4,938)	(5,291)
Total debt	\$ 1,879,800	\$ 1,856,700
Less current maturities	(51,289)	(36,594)
Total long-term debt	\$ 1,828,511	\$ 1,820,106

Current maturities of debt at June 30, 2008 were comprised primarily of capital leases and our 7.7% Notes due April 2009. Our consolidated debt had a weighted average interest rate of 6.77% at June 30, 2008 and 7.09% at December 31, 2007. Approximately 86% and 89% of our total debt had a fixed interest rate at June 30, 2008 and December 31, 2007, respectively.

Revolving Credit Facility

Our revolving credit facility matures in November 2011 and provides a total lending commitment of \$300.0 million, including a sublimit of \$175.0 million for letters of credit. In March 2008, we utilized \$45.0 million of the credit facility to repay our 6.5% notes due March 2008. As of June 30, 2008, we have also used the credit facility to support \$53.7 million of letters of credit. The credit facility provides us with flexibility for working capital, if needed, and is guaranteed by our domestic subsidiaries. The subsidiary guaranty is a guaranty of payment of the outstanding amount of the total lending commitment. It covers the term of the credit facility, including extensions, and totaled a maximum potential amount of \$98.7 million at June 30, 2008. The credit facility contains certain financial covenants, including a minimum interest coverage ratio, a maximum leverage ratio, maximum capital expenditure limitations, and certain cash distribution and share repurchase restrictions. We also pay a quarterly fee on the unused commitment, which ranges from 0.25% to 0.50%.

Debt Issuances and Additions

During the six months ended June 30, 2008, we entered into loan agreements with financial institutions totaling \$31.0 million. The proceeds, which are included in mortgage notes and other debt, were used for deposits related to certain transportation vehicles.

In the three months ended June 30, 2007, we completed a private offering of \$400.0 million aggregate principal unsecured senior notes, consisting of \$200.0 million aggregate principal amount of 6.75% Senior Notes due 2015 and

\$200.0 million aggregate principal amount of 7.50% Senior notes due 2027. We are entitled to redeem the notes at any time by paying a make-whole premium. The notes are subject to the provisions of our Senior Indenture dated as of February 1, 1993, as amended, which includes covenants limiting, among other things, the creation of liens securing the indebtedness and certain sale-leaseback transactions. We used the net proceeds from the offering to fund the closing of the tender offers for our 6.50% Notes due 2008 and 7.70% Notes due 2009 as further discussed below and for general corporate purposes.

Debt Extinguishments and Reductions

In the three months ended March 31, 2008, we repaid \$45.2 million aggregate principal amount of our 6.50% notes due March 2008. There was no gain or loss recognized as a result of this repayment.

In the three months ended March 31, 2007, we repaid \$100.0 million aggregate principal amount of our term loan. As a result of this transaction, we recognized a loss of \$2.4 million recorded in *Loss on early extinguishment of debt, net* in our condensed consolidated statement of operations, which represents the write-off of unamortized deferred loan costs of \$1.7 million and a \$0.7 million premium to early extinguish the debt.

In the three months ended June 30, 2007, we purchased \$149.8 million aggregate principal amount of our 6.50% Notes due 2008 and \$173.8 million aggregate principal amount of our 7.70% Notes due 2009 in a tender offer. In connection with the repurchase of the notes, we recognized a *Loss on early extinguishment of debt* of approximately \$12.1 million, which represents the write-off of unamortized deferred loan costs of \$0.4 million, a \$1.0 million loss on a related interest rate hedge, and \$10.7 million in premiums paid to extinguish the debt.

Capital Leases

In the six months ended June 30, 2008 and 2007, we acquired \$14.3 million and \$23.9 million, respectively, of transportation vehicles and other assets using capital leases.

10. Retirement Plans

The components of net periodic pension plan benefit cost for the three and six months ended June 30 were as follows:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
	(In thousands)		(In thousands)	
Interest cost on projected benefit obligation	\$ 422	\$ 2,083	\$ 785	\$ 4,166
Actual return on plan assets		(909)		(1,935)
Amortization of prior service cost		46		92
	\$ 422	\$ 1,220	\$ 785	\$ 2,323

11. Share-Based Compensation

Stock Benefit Plans

We utilize the Black-Scholes valuation model for estimating the fair value of our stock options. This model allows the use of a range of assumptions related to volatility, the risk-free interest rate, the expected life, and the dividend yield. The fair values of our stock options are calculated using the following weighted average assumptions for the six months ended June 30, 2008:

Assumptions	Six months ended June 30, 2008
Dividend yield	1.3%
Expected volatility	45.9%
Risk-free interest rate	2.9%
Expected holding period	5.7 years

Stock Options

The following table sets forth stock option activity for the six months ended June 30, 2008:

	Options	Weighted-average exercise price
Outstanding at December 31, 2007	13,568,445	\$ 6.25
Granted	1,422,600	11.59
Exercised	(947,202)	3.79
Expired	(7,263)	29.82

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Outstanding at June 30, 2008	14,036,580	\$ 6.95
Exercisable at June 30, 2008	10,631,099	\$ 5.71

As of June 30, 2008, the unrecognized compensation expense related to stock options of \$11.3 million is expected to be recognized over a weighted average period of 2.2 years.

Restricted Shares

Restricted share activity for the six months ended June 30, 2008 was as follows:

	Restricted shares	Weighted-average grant-date fair value
Nonvested restricted shares at December 31, 2007	674,576	\$ 9.04
Granted	290,000	11.61
Vested	(362,134)	8.36
Nonvested restricted shares at June 30, 2008	602,442	\$ 10.69

12. Stockholders Equity

Our components of *Accumulated other comprehensive income* are as follows:

	Foreign currency translation adjustment	Unrealized gains and losses (in thousands)	Accumulated other comprehensive income
Balance at December 31, 2007	\$ 152,590	\$	\$ 152,590
Activity in 2008	(17,147)		(17,147)
Decrease in net unrealized gains associated with available-for-sale securities of the trusts		(142,954)	(142,954)
Reclassification of unrealized loss activity attributable to the non-controlling interest holders		142,954	142,954
Balance at June 30, 2008	\$ 135,443	\$	\$ 135,443

The assets and liabilities of foreign operations are translated into U.S. dollars using the current exchange rate. The U.S. dollar amount that arises from such translation, as well as exchange gains and losses on intercompany balances of a long-term investment nature, are included in the cumulative currency translation adjustments in *Accumulated other comprehensive income*. Income taxes are generally not provided on foreign currency translation adjustments. Included in the decrease in net unrealized gains associated with available-for-sale securities of the trusts and offset in the reclassification of unrealized loss activity attributable to the non-controlling interest holders are \$9.9 million of unrealized losses attributable to the initial adoption of SFAS 157. See Note 4-6 for further discussion.

The components of comprehensive income are as follows for the three and six months ended June 30, 2008 and 2007:

	Three months ended June 30, 2008		Six months ended June 30, 2008	
	2008	2007	2008	2007
	(In thousands)		(In thousands)	
Comprehensive income:				
Net income	\$ 31,397	\$ 15,118	\$ 72,916	\$ 52,760
Other comprehensive income (loss)	4,959	37,190	(17,147)	41,596

Comprehensive income	\$ 36,356	\$ 52,308	\$ 55,769	\$ 94,356
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Cash Dividends

On May 14, 2008, our Board of Directors approved a cash dividend of \$.04 per common share. At June 30, 2008, this dividend totaling \$10.3 million was recorded in *Accounts payable and accrued liabilities* and *Capital in excess of par value* in the condensed consolidated balance sheet. This dividend was paid on July 31, 2008.

Share Repurchase Program

Subject to market conditions, normal trading restrictions, and limitations in our debt covenants, we may make purchases in the open market or through privately negotiated transactions under our stock repurchase program. In the six months ended June 30, 2008, we repurchased 7.0 million shares of common stock at an aggregate cost of \$79.5 million and an average cost per share of \$11.34. After these purchases, the remaining dollar value of shares authorized to be purchased under the share repurchase program was approximately \$66.1 million at June 30, 2008.

13. Segment Reporting

Our operations are both product based and geographically based, and the reportable operating segments presented below include our funeral and cemetery operations. Our geographic areas include United States and Foreign.

Foreign operations consists of our operations in Canada and Germany. We conduct both funeral and cemetery operations in the United States and Canada and funeral operations in Germany.

Our reportable segment information is as follows:

	Funeral	Cemetery (In thousands)	Reportable segments
Three months ended June 30,			
Revenues from external customers:			
2008	\$363,262	\$185,520	\$ 548,782
2007	\$375,852	\$189,640	\$ 565,492
Gross profit:			
2008	\$ 72,372	\$ 34,988	\$ 107,360
2007	\$ 70,490	\$ 32,749	\$ 103,239
Six months ended June 30,			
Revenues from external customers:			
2008	\$768,841	\$353,392	\$1,122,233
2007	\$798,696	\$374,351	\$1,173,047
Gross profit:			
2008	\$180,919	\$ 64,038	\$ 244,957
2007	\$172,735	\$ 71,487	\$ 244,222

The following table reconciles gross profit from reportable segments to our consolidated income from continuing operations before income taxes:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
	(In thousands)		(In thousands)	
Gross profit from reportable segments	\$ 107,360	\$ 103,239	\$ 244,957	\$ 244,222
General and administrative expenses	(21,658)	(30,159)	(46,733)	(65,387)
(Loss) gain on divestitures and impairment charges, net	(3,858)	9,743	(15,904)	2,063
Other operating income, net	1,691		585	
Operating income	83,535	82,823	182,905	180,898
Interest expense	(33,311)	(36,165)	(67,380)	(73,762)
Loss on early extinguishment of debt		(12,122)		(14,480)
Equity in earnings of unconsolidated subsidiaries		5,559		6,270
Other income, net	1,945	1,755	3,117	1,138

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Income from continuing operations before income taxes	\$ 52,169	\$ 41,850	\$ 118,642	\$ 100,064
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Our geographic area information is as follows:

	United States	Foreign (In thousands)	Total
Three months ended June 30,			
Revenues from external customers:			
2008	\$ 492,297	\$ 56,485	\$ 548,782
2007	\$ 519,596	\$ 45,896	\$ 565,492
(Loss) gain on divestitures and impairment charges, net:			
2008	\$ (3,333)	\$ (525)	\$ (3,858)
2007	\$ 10,279	\$ (536)	\$ 9,743
Operating income:			
2008	\$ 70,649	\$ 12,886	\$ 83,535
2007	\$ 81,400	\$ 1,423	\$ 82,823
Six months ended June 30,			
Revenues from external customers:			
2008	\$1,011,344	\$110,889	\$1,122,233
2007	\$1,080,888	\$ 92,159	\$1,173,047
(Loss) gain on divestitures and impairment charges, net:			
2008	\$ (12,871)	\$ (3,033)	\$ (15,904)
2007	\$ 2,576	\$ (513)	\$ 2,063
Operating income:			
2008	\$ 160,378	\$ 22,527	\$ 182,905
2007	\$ 175,610	\$ 5,288	\$ 180,898

14. Supplementary Information

The detail of certain income statement accounts as presented in the condensed consolidated statement of operations is as follows for the three and six months ended June 30:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
	(In thousands)		(In thousands)	
Merchandise revenues:				
Funeral	\$ 118,312	\$ 127,164	\$ 252,533	\$ 273,898
Cemetery	129,021	128,810	237,453	248,262
Total merchandise revenues	247,333	255,974	489,986	522,160
Services revenues:				
Funeral	229,542	236,197	489,052	502,157
Cemetery	47,862	52,703	98,912	109,462
Total services revenues	277,404	288,900	587,964	611,619
Other revenues	24,045	20,618	44,283	39,268
Total revenues	\$ 548,782	\$ 565,492	\$ 1,122,233	\$ 1,173,047

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Merchandise costs and expenses:				
Funeral	\$ 61,239	\$ 64,278	\$ 129,902	\$ 135,930
Cemetery	58,321	55,357	104,697	102,021
Total cost of merchandise	119,560	119,635	234,599	237,951
Services costs and expenses:				
Funeral	113,538	122,335	225,616	241,241
Cemetery	28,170	29,348	55,349	57,184
Total cost of services	141,708	151,683	280,965	298,425
Overhead and other expenses	180,154	190,935	361,712	392,449
Total costs and expenses	\$ 441,422	\$ 462,253	\$ 877,276	\$ 928,825

15. Commitments and Contingencies**Representations and Warranties**

As of June 30, 2008, we have contingent obligations of \$36.1 million (of which \$26.6 million is reflected in our condensed consolidated financial statements as a liability) resulting from our previous international asset sales and joint venture transactions. In some cases, we have agreed to guarantee certain representations and warranties made in such divestiture transactions with letters of credit or interest-bearing cash investments. We have interest-bearing cash investments of \$25.6 million included in *Deferred charges and other assets* collateralizing certain of these contingent obligations. We believe it is remote that we will ultimately be required to fund third-party claims against these representations and warranties in excess of the carrying value of our recorded liability.

In 2004, we disposed of our funeral operations in France to a newly formed, third-party company. As a result of this sale, we recognized certain Euro-denominated contractual obligations related to representations, warranties, and other indemnifications. The remaining obligation related to these indemnifications is as follows:

	Time limit	Maximum potential amount of future payments	Carrying value as of June 30, 2008 (In thousands)
Litigation provision	Until entire resolution of (i) the relevant claims or (ii) settlement of the claim by the purchaser at the request of the vendor	(1)	15,117
VAT taxes	One month after expiration of the statutory period of limitations	(1)	5,688
Other	Until entire resolution of (i) the relevant claims or (ii) settlement of the claim by the purchaser at the request of the vendor	(1)	4,266
Total			\$ 25,071
Less: Deductible of majority equity owner			(2,471)
			\$ 22,600

(1) The potential maximum exposure for these three items combined is 60 million or \$94.8 million at June 30, 2008.

During the six months ended June 30, 2008, we released certain value-added tax (VAT) indemnifications and tax reserve liabilities related to our former French operations as a result of the expiration of the statutory period of limitations. In addition, we applied certain litigation and other claims against the deductible of the majority owner, and we increased the recorded amount of certain other litigation reserves. These transactions, which after consideration of related foreign currency translation effects resulted in a \$1.0 million reduction of our carrying value of the obligation, were recorded in *(Loss) gain on divestitures and impairment charges, net* in the three and six months ended June 30, 2008.

Litigation

We are a party to various litigation matters, investigations, and proceedings. For each of our outstanding legal matters, we evaluate the merits of the case, our exposure to the matter, possible legal or settlement strategies, and the likelihood of an unfavorable outcome. We intend to defend ourselves in the lawsuits described herein; however, if we determine that an unfavorable outcome is probable and can be reasonably estimated, we establish accruals we deem appropriate. We hold certain insurance policies that may reduce cash outflows with respect to an adverse outcome of certain of these litigation matters. We accrue such insurance recoveries when they become probable of being paid and can be reasonably estimated.

Conley Investment Counsel v. Service Corporation International, et al.; Civil Action 04-MD-1609; In the United States District Court for the Southern District of Texas, Houston Division, a consolidation of three cases that were filed in 2003 and 2004 (2003 Securities Lawsuit). The 2003 Securities Lawsuit names as defendants SCI and several of SCI's current and former executive officers or directors. It is a purported class action alleging that the defendants failed to disclose the unlawful treatment of human remains and gravesites at two cemeteries in Fort Lauderdale and West Palm Beach, Florida. No discovery has occurred, and we cannot quantify our ultimate liability, if any, for the payment of damages.

Burial Practices Claims. We are named as a defendant in various lawsuits alleging improper burial practices at certain of our cemetery locations. These lawsuits include the *Valls* and *Garcia* lawsuits described in the following paragraphs.

Maria Valls, Pedro Valls and Roberto Valls, on behalf of themselves and all other similarly situated v. SCI Funeral Services of Florida, Inc. d/b/a Memorial Plan a/k/a Flagler Memorial Park, John Does and Jane Does; Case No. 23693CA08; In the Circuit Court of the 11th Judicial Circuit in Miami-Dade County, Florida (Valls Lawsuit). The Valls Lawsuit was filed December 5, 2005, and named a subsidiary of SCI as a defendant. The plaintiffs allege the defendants improperly handled remains, did not keep adequate records of interments, and engaged in various other improprieties in connection with the operation of the cemetery. Although the plaintiffs seek to certify as a class all family members of persons buried at the cemetery, the court has dismissed plaintiffs' class action allegations with prejudice. Plaintiffs appeal the ruling. The plaintiffs are seeking monetary damages and injunctive relief and have reserved the right to seek leave from the court to claim punitive damages. We cannot quantify our ultimate liability, if any, for the payment of any damages.

Reyvis Garcia, Alicia Garcia, et al. v. Alderwoods Group, Inc., Osiris Holding of Florida, Inc, a Florida corporation, d/b/a Graceland Memorial Park South, f/k/a Paradise Memorial Gardens, Inc., et al. was filed in December 2004, in the Circuit Court of the Eleventh Judicial Circuit in Miami-Dade County, Florida, Case No.: 04-25646 CA 32. The Garcias are the son and sister of the decedent, Eloisa Garcia, who was buried at Graceland Memorial Park South in March 1986, when the cemetery was owned by Paradise Memorial Gardens, Inc. Initially, the suit sought damages on the individual claims of the Garcias relating to the burial of Eloisa Garcia. The Garcias claimed that due to poor record keeping, maps, and the fact that the family could not afford to purchase a marker for the grave, the burial location of the decedent could not be readily located. Subsequently, the decedent's grave was located and verified. In July 2006, plaintiffs amended their complaint, seeking to certify a class of all persons buried at this cemetery whose burial sites cannot be located. Plaintiffs subsequently filed amended class action complaints and added additional named plaintiffs. The plaintiffs are seeking unspecified monetary damages, as well as equitable and injunctive relief. No class has been certified in this matter. We cannot quantify our ultimate liability, if any, for the payment of any damages.

Funeral Regulations Lawsuits. We are named as a defendant in various lawsuits alleging violations of federal and state funeral related regulations and/or statutes, including the *Baudino* and *Sanchez* lawsuits described in the following paragraphs.

Mary Louise Baudino, et al. v. Service Corporation International, et al. was filed in November 2004 in Los Angeles County Superior Court; Case No. BC324007 (Baudino Lawsuit). The Baudino Lawsuit was initially filed as a putative nationwide class action brought on behalf of all persons, entities, and organizations who purchased funeral services from SCI. Plaintiffs allege that funeral related regulations and/or statutes (Rules) required us to disclose our markups on all items obtained from third parties in connection with funeral service contracts and that the failure to make certain disclosures of markups resulted in breach of contract and other legal claims. The plaintiffs seek to recover an unspecified amount of monetary damages as well as attorneys' fees, costs, and interest. We deny all of the

claims and deny that the plaintiffs have standing to sue for violations of the Rules. On September 15, 2006, the trial court granted our motion for summary judgment on the merits. Plaintiffs are appealing the summary judgment ruling.

Richard Sanchez et al. v. Alderwoods Group, Inc. et al. was filed in February 2005 in the Superior Court of the State of California, for the County of Los Angeles, Central District; Case No. BC328962. Plaintiffs seek to certify a nationwide class on behalf of all consumers who purchased funeral goods and services from Alderwoods. Plaintiffs allege in essence that the Federal Trade Commission's Funeral Rule requires Alderwoods to disclose its markups on all items obtained from third parties in connection with funeral service contracts. Plaintiffs allege further that Alderwoods has failed to make such disclosures. Plaintiffs seek to recover an unspecified amount of monetary damages, attorney's fees, costs, and unspecified injunctive and declaratory relief. This case is substantially similar to the Baudino Lawsuit, and we expect that the outcome of this case will be governed by the law applied in the Baudino Lawsuit.

Antitrust Claims. We are named as a defendant in two related class action antitrust cases filed in 2005. The first case is Cause No. 4:05-CV-03394; *Funeral Consumers Alliance, Inc. v. Service Corporation International, et al.*; In the United States District Court for the Southern District of Texas – Houston (Funeral Consumers Case). This is a purported class action on behalf of casket consumers throughout the United States alleging that we and several other companies involved in the funeral industry violated federal antitrust laws and state consumer laws by engaging in various anti-competitive conduct associated with the sale of caskets.

The second case is Cause No. 4:05-CV-03399; *Pioneer Valley Casket, et al. v. Service Corporation International, et al.*; In the United States District Court for the Southern District of Texas – Houston Division (Pioneer Valley Case). This lawsuit makes the same allegations as the Funeral Consumers Case and is also brought against several other companies involved in the funeral industry. Unlike the Funeral Consumers Case, the Pioneer Valley Case is a purported class action on behalf of all independent casket distributors that are in the business or were in the business any time between July 18, 2001 to the present.

The Funeral Consumers Case and the Pioneer Valley Case seek injunctions, monetary damages, and treble damages. The plaintiffs in the Funeral Consumers Case filed an expert report indicating that the damages sought from all defendants range from approximately \$950 million to \$1.5 billion, before trebling. Additionally, the plaintiffs in the Pioneer Valley Case filed an expert report indicating that the damages sought from all defendants would be approximately \$99 million, before trebling. We deny that we engaged in anticompetitive practices related to our casket sales and intend to vigorously contest these claims and plaintiffs' damages reports. In both cases, we have filed reports of our experts which vigorously dispute the validity of the plaintiffs' damages theories and calculations. We cannot quantify our ultimate liability, if any, for the payment of damages.

In addition to the Funeral Consumers Case and the Pioneer Valley Case, we received Civil Investigative Demands, dated August 2005 and February 2006, from the Attorney General of Maryland on behalf of itself and other state attorneys general, who have commenced an investigation of alleged anticompetitive practices in the funeral industry. We have also received similar Civil Investigative Demands from the Attorneys General of Florida and Connecticut.

Wage and Hour Claims. We are named a defendant in various lawsuits alleging violations of federal and state laws regulating wage and hour overtime pay, including the lawsuits described in the following paragraphs.

Prise, et al., v. Alderwoods Group, Inc., and Service Corporation International; Cause No. 06-164; In the United States District Court for the Western District of Pennsylvania (the Wage and Hour Lawsuit). The Wage and Hour Lawsuit was filed by two former Alderwoods (Pennsylvania), Inc., employees in December 2006 and purports to have been brought under the Fair Labor Standards Act (FLSA) on behalf of all Alderwoods and SCI-affiliated employees who performed work for which they were not fully compensated, including work for which overtime pay was owed. The court has conditionally certified a class of claims as to certain job positions for Alderwoods employees.

Plaintiffs allege causes of action for violations of the FLSA, failure to maintain proper records, breach of contract, violations of state wage and hour laws, unjust enrichment, fraud and deceit, quantum meruit, negligent misrepresentation, and negligence. Plaintiffs seek injunctive relief, unpaid wages, liquidated, compensatory, consequential and punitive damages, attorneys' fees and costs, and pre- and post-judgment interest. We cannot quantify our ultimate liability, if any, in this lawsuit.

Bryant, et al. v. Alderwoods Group, Inc., Service Corporation International, et al.; Case No. 3:07-CV-5696-SI; In the U.S. District Court for the Northern District of California. This lawsuit was filed on November 8, 2007 against SCI and various subsidiaries and individuals. It is related to the Wage and Hour Lawsuit, raising similar claims and brought by the same attorneys. This lawsuit has been transferred to the U.S. District Court for the Western District of Pennsylvania and is now Case No. 08-CV-00891-JFC. We cannot quantify our ultimate liability, if any, in this lawsuit.

Bryant, et al. v. Service Corporation International, et al.; Case No. RG-07359593; and *Helm, et al. v. AWGI & SCI*; Case No. RG-07359602; In the Superior Court of the State of California, County of Alameda. These cases were filed on December 5, 2007 by counsel for plaintiffs in the Wage and Hour Lawsuit. These cases assert state law claims like those previously dismissed in the Wage and Hour Lawsuit. These cases were removed to federal court in the U.S. District Court for the Northern District of California, San Francisco/Oakland Division. The *Bryant* case is now Case No. 3:08-CV-01190-SI and the *Helm* case is now Case No. 3:08-CV-01184-SI. We cannot quantify our ultimate

liability, if any, in this lawsuit.

Stickle, et al. v. Service Corporation International, et al.; Case No. 08-CV-83; In the U.S. District Court for Arizona, Phoenix Division. Counsel for plaintiffs in the Wage and Hour Lawsuit filed this case on January 17, 2008, against SCI and various related entities and individuals asserting FLSA and other ancillary claims based on the alleged failure to pay for overtime. Plaintiffs seek the same class notice to SCI and related entities that were rejected by the Court in the Wage and Hour Lawsuit. We cannot quantify our ultimate liability, if any, in this lawsuit.

Ordaz, et al. v. Rose Hills Mortuary, L.P., et al.; Case No. BC 386500; In the Superior Court of the State of California, for the County of Los Angeles. This case was filed on February 28, 2008 as a purported class action against our Rose Hills location asserting claims based on various violations of California law relating to the payment of wages and work hours.

The ultimate outcome of the matters described above cannot be determined at this time. We intend to aggressively defend all of the above lawsuits; however, an adverse decision in one or more of such matters could have a material adverse effect on us, our financial condition, results of operations, and cash flows.

16. Earnings Per Share

Basic earnings per common share (EPS) excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other obligations to issue common stock were exercised or converted into common stock or resulted in the issuance of common shares that then shared in our earnings.

A reconciliation of the numerators and denominators of the basic and diluted EPS computations is presented below:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
	(In thousands, except per share amounts)		(In thousands, except per share amounts)	
Income from continuing operations (numerator):				
Income from continuing operations basic	\$ 31,774	\$ 12,909	\$ 73,278	\$ 47,626
After tax interest on convertible debt	13		25	
Income from continuing operations diluted	\$ 31,787	\$ 12,909	\$ 73,303	\$ 47,626
(Loss) income from discontinued operations, net of tax (numerator)	\$ (377)	\$ 2,209	\$ (362)	\$ 5,134
Net income (numerator):				
Net income basic	\$ 31,397	\$ 15,118	\$ 72,916	\$ 52,760
After tax interest on convertible debt	13		25	
Net income diluted	\$ 31,410	\$ 15,118	\$ 72,941	\$ 52,760
Denominator:				
Weighted average shares basic	259,034	290,577	259,919	291,941
Stock options	3,356	5,361	3,543	5,318
Restricted stock	64	186	129	221
Convertible debt	121		121	
Weighted average shares diluted	262,575	296,124	263,712	297,480
Income from continuing operations per share:				
Basic	\$.12	\$.04	\$.28	\$.16

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Diluted	\$.12	\$.04	\$.28	\$.16
Income from discontinued operations per share, net of tax:				
Basic	\$	\$.01	\$	\$.02
Diluted	\$	\$.01	\$	\$.02
Net income per share:				
Basic	\$.12	\$.05	\$.28	\$.18
Diluted	\$.12	\$.05	\$.28	\$.18

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The computation of diluted EPS excludes outstanding stock options and convertible debt in certain periods in which the inclusion of such options and debt would be antidilutive in the periods presented. Total options and convertible debentures not currently included in the computation of dilutive EPS are as follows (in shares):

	Three months ended June 30,		Six months ended June 30,	
	2008 (In thousands)	2007	2008 (In thousands)	2007
Antidilutive options	3,526	1,622	1,544	1,559
Antidilutive convertible debentures	52	307	52	312
Total common stock equivalents excluded from computation	3,578	1,929	1,596	1,871

17. Divestiture-Related Activities

As divestitures occur in the normal course of business, gains or losses on the sale of such businesses are recognized in the income statement line item *(Loss) gain on divestitures and impairment charges, net*, including adjustments to contingent obligations and other estimated amounts which are recognized in periods subsequent to the period of divestment.

(Loss) gain on divestitures and impairment charges, net consists of the following for the three and six months ended June 30:

	Three months ended June 30,		Six months ended June 30,	
	2008 (In thousands)	2007	2008 (In thousands)	2007
Gain (loss) on divestitures, net	\$ 604	\$ 28,851	\$ (8,471)	\$ 21,206
Impairment losses	(4,462)	(19,108)	(7,433)	(19,143)
	\$ (3,858)	\$ 9,743	\$ (15,904)	\$ 2,063

Assets Held for Sale

We have committed to a plan to sell certain operating properties. As a result, these properties have been classified as assets held for sale in our June 30, 2008 and December 31, 2007 condensed consolidated balance sheets.

Net assets held for sale were as follows:

	June 30, 2008	December 31, 2007
	(In thousands)	
Assets:		
Current assets	\$ 1,805	\$ 2,294
Preneed funeral receivables and trust investments	9,624	9,944
Preneed cemetery receivables and trust investments	62,872	64,751
Cemetery property	7,639	9,341
Property and equipment, at cost	12,454	9,968
Deferred charges and other assets	12,003	12,390
Cemetery perpetual care trust investments	16,407	16,232
Total assets	122,804	124,920
Liabilities:		
Accounts payable and accrued liabilities	201	149
Deferred preneed funeral revenues	7,913	8,388
Deferred preneed cemetery revenues	65,190	67,141
Other liabilities	144	167
Non-controlling interest in cemetery perpetual care trusts	16,407	16,232
Total liabilities	89,855	92,077
Net assets held for sale	\$ 32,949	\$ 32,843

Discontinued Operations

As part of the Alderwoods transaction, we acquired an insurance subsidiary that we sold in the third quarter of 2007. Accordingly, the operations of this entity are classified as discontinued operations for the three and six months ended June 30, 2007. In addition, in the second quarter of 2008, we settled an outstanding contingency related to the 2005 divestiture of our operations in Argentina. The loss related to this transaction is included in discontinued operations for the three and six months ended June 30, 2008.

The results of our discontinued operations for the three and six months ended June 30, 2008 and 2007 were as follows:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
	(In thousands)		(In thousands)	
Revenues	\$	\$ 17,162	\$	\$ 42,626
Costs and other expenses		(14,646)		(36,448)
Other income		916		916
Loss on divestitures and impairment charges, net	(572)		(557)	
	(572)	3,432	(557)	7,094

(Loss) income from discontinued operations before income taxes				
Benefit (provision) for income taxes	195	(1,223)	195	(1,960)
(Loss) income from discontinued operations	\$ (377)	\$ 2,209	\$ (362)	\$ 5,134

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The Company

We are 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 June 30, 2008, we operated 1,328 funeral service locations and 379 cemeteries (including 209 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 the Alderwoods Group, Inc.

(Alderwoods) transaction 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 condensed consolidated statement of operations.

We currently have approximately \$66.1 million authorized to repurchase our common stock. Our financial stability is further enhanced by our \$6.8 billion backlog of future revenues from both trust and insurance funded sales at June 30, 2008, which is the result of preneed funeral and cemetery sales. We believe we have the financial strength and flexibility to reward shareholders through dividends while maintaining a prudent capital structure and pursuing new opportunities for profitable growth.

Strategies for Growth

We are confident about our competitive position, our financial strength, and our ability to further our principal strategies to generate profitable growth over the long-term. These strategies are as follows:

Target our customer;

Drive operating discipline and leverage our scale; and

Manage and grow the footprint.

For additional information on these strategies, see our Annual Report on Form 10-K for the year ended December 31, 2007.

Financial Condition, Liquidity and Capital Resources

Capital Allocation Considerations

We rely on cash flow from operations as a significant source of liquidity. In addition, we have approximately \$201.3 million in borrowing capacity under our 5-year, \$300.0 million revolving credit facility. We believe these sources of liquidity can be supplemented by our ability to access the capital markets for additional debt or equity securities. As of June 30, 2008, we were in compliance with all of our debt covenants.

At June 30, 2008, our current liabilities exceeded our current assets by \$15.3 million. We believe our future operating cash flows and available capacity under our credit facility will be adequate to meet our working capital requirements.

Cash Flow

We believe our ability to generate strong operating cash flow is one of our fundamental financial strengths and provides us with substantial flexibility in meeting operating and investing needs. Highlights of cash flow for the six months ended June 30, 2008 and 2007 are as follows:

Operating Activities Net cash provided by operating activities in the first half of 2008 was \$116.5 million compared to \$191.6 million in the first half of 2007. Included in the first half of 2008 is a federal tax payment of \$90.0 million related to gains on the sale of our equity investment in French operations and other divestitures in late 2007 and \$3.3 million of Alderwoods transition costs. Included in the first half of 2007 is \$11.4 million of premiums paid on early extinguishment of debt and \$19.5 million of Alderwoods transition costs. Net cash provided by operating activities also decreased \$12.6 million, or 5.7%, due largely to our sale of Mayflower Insurance Company, which contributed \$17.3 million of operating cash from discontinued operations in the first half of 2007.

Investing Activities Net cash provided by investing activities decreased \$223.8 million in the first half of 2008 compared to the first half of 2007 primarily due to a \$201.7 million decrease in proceeds from the sales of businesses in North America and a \$21.2 million increase in deposits of restricted funds. In the first half of 2007, we received \$214.2 million in proceeds from the sales of businesses in North America driven by the sale of properties in accordance with our consent decree with the FTC.

Financing Activities Net cash used in financing activities decreased \$54.2 million in the first half of 2008 compared to the same period in 2007 as a \$372.2 million decrease in debt payments and a \$24.1 million decrease in purchases of the Company's common stock were partially offset by a \$320.6 million decrease in proceeds from the issuance of long-term debt and a \$9.6 million reduction in proceeds from the exercise of stock options. Payments of debt in 2008 included a \$45.2 million repayment of our 6.5% notes due

March 2008, \$9.2 million in other scheduled debt payments, and \$12.0 million in payments on capital leases. Payments of debt of \$438.6 million in 2007 were due to the acceptance of the tenders of \$149.8 million of our 6.50% senior notes due 2008 and \$173.8 million of our 7.70% senior notes due 2009, a \$100.0 million repayment of our term loan, \$2.2 million in scheduled debt payments, and \$13.8 million in payments on capital leases.

Financial Assurances

In support of our operations, we have entered into arrangements with certain surety companies whereby such companies agree to issue surety bonds on our behalf as financial assurance and/or as required by existing state and local regulations. The surety bonds are used for various business purposes; however, the majority of the surety bonds issued and outstanding have been used to support our preneed funeral and cemetery sales activities that are not backed by trust investments. The obligations underlying these surety bonds are recorded on the condensed consolidated balance sheet as *Deferred preneed funeral revenues* and *Deferred preneed cemetery revenues*. The breakdown of surety bonds between funeral and cemetery preneed arrangements, as well as surety bonds for other activities, is described below.

	June 30, 2008	December 31, 2007
	(Dollars in millions)	
Preneed funeral	\$ 129.9	\$ 134.9
Preneed cemetery:		
Merchandise and services	136.3	148.0
Pre-construction	4.0	6.4
Bonds supporting preneed funeral and cemetery obligations	270.2	289.3
Bonds supporting preneed business permits	5.1	5.4
Other bonds	17.0	8.4
Total surety bonds outstanding	\$ 292.3	\$ 303.1

When selling preneed funeral and cemetery contracts, we may post surety bonds where Labor Trouble. Experienced or, to the best knowledge of Grand, been threatened by any strike, work stoppage, organizational effort, or other labor trouble, or any other event or condition of any similar character which has been or could reasonably be expected to be materially adverse to the business, income, or financial condition of Grand or any of its subsidiaries. A-21 4.29.3 Mortgage of Assets. Mortgaged, pledged, or subjected to lien, charge, or other encumbrance any of its assets, or sold or transferred any such assets, except in the ordinary course of business, except for such mortgages, pledges, liens, charges, and encumbrances for indebtedness that does not individually exceed \$25,000, or do not collectively exceed \$75,000. 4.29.4 Contract Amendment or Termination. Made or permitted any amendment or termination of any contract to which it is a party and which is material to the business, income, or financial condition of Grand and its subsidiaries. 4.30 Allowance for Loan Losses. The allowance for loan losses reflected in Grand's audited consolidated financial statements and Call Reports for the fiscal year ended December 31, 2000, and for the fiscal quarter ended September 30, 2001 (as applicable) and any audited consolidated financial statements and unaudited Call Reports for any subsequent year or quarter, was or will be (as applicable) in the reasonable opinion of management of Grand (a) adequate to meet all reasonably anticipated loan losses, net of recoveries related to loans previously charged off as of those dates, and (b) consistent with GAAP or RAP (as applicable) consistently applied and safe and sound banking practices. 4.31 Agreements With Bank Regulators. Neither Grand nor any of Grand's subsidiaries is a party to any agreement or memorandum of understanding with, or a party to any commitment letter, board resolution or similar undertaking to, or is subject to any order or directive by, or is a recipient of any extraordinary supervisory letter from, any governmental authority that restricts materially the conduct of its business, or in any manner relates to its capital

adequacy, its credit or reserve policies or its management, nor has Grand been advised by any governmental authority that it is contemplating issuing or requesting (or is considering the appropriateness of issuing or requesting) any such order, decree, agreement, memorandum of understanding, extraordinary supervisory letter, commitment letter or similar submission. As of the date of this Plan of Merger, Grand knows of no reason why the regulatory approvals referred to in Section 4.1.4 (Required Approvals) cannot be obtained or why this process would be materially impeded. 4.32 True and Complete Information. No schedule, statement, list, certificate, or other information furnished or to be furnished by Grand in connection with this Plan of Merger, including the Grand Disclosure Statement, contains or will contain any untrue statement of a material fact, or omits or will omit to state a material fact necessary to make the statements contained therein, in light of the circumstances in which they are made, not misleading.

ARTICLE V CERTAIN COVENANTS 5.1 Disclosure Statement. The Grand Disclosure Statement and the Macatawa Disclosure Statement (collectively the "Disclosure Statements" or individually a "Disclosure Statement") shall contain appropriate references and cross references with respect to each of the disclosures, and appropriate identifying markings with respect to each of the documents, that pertain to one or more sections or articles of this Plan of Merger.

Grand and Macatawa have each prepared and delivered a copy of its Disclosure Statement to the other party. Not less than 5 days prior to the Closing, each party shall deliver to the other an update to its Disclosure Statement describing any material changes and containing any new or amended documents, as specified below, which are not contained in its Disclosure Statement as initially delivered. Such update shall not cure any breach of a representation or warranty occurring on the date of this Plan of Merger. Each of Grand's and Macatawa's Disclosure Statement and its respective update shall be certified on its behalf by appropriate executive officers that such Disclosure Statement contains no untrue statement of a material fact, or fails to omit to state a material fact necessary to make the statements contained therein, in light of the circumstances in which they are made, not misleading. 5.2 Changes Affecting Representations.

While this Plan of Merger is in effect, if either Macatawa or Grand becomes aware of any facts or of the occurrence of impending occurrence of any event that (a) would cause one or more of the representations and warranties it has given in this Plan of Merger, subject to the exceptions contained in the Macatawa Disclosure Statement or the Grand Disclosure Statement, respectively, to become untrue or incomplete in any material respect; or (b) would have caused one or more of such representations and warranties to be untrue or incomplete in any material respect had such facts been known or had such event occurred prior to the date of this Plan of Merger, then such party shall immediately give detailed written notice of such discovery or change, including a detailed description of the underlying facts or events, together with all pertinent documents, to the other party. 5.3 Conduct of Business Pending the Effective Time

of the Merger. From the date of the execution of this Plan of Merger until the Effective Time of the Merger, Grand agrees that, except as consented to in writing by Macatawa or as otherwise provided in this Plan of Merger, it shall, and it shall cause all of its subsidiaries to: A-22 5.3.1 Ordinary Course. Conduct their business and manage their property only in the usual, regular, and ordinary course and not otherwise, in substantially the same manner as prior to the date of the execution of this Plan of Merger, and not make any substantial change to their methods of management or operation in respect of such business or property. 5.3.2 No Inconsistent Actions. Take no action which would be inconsistent with or contrary to the representations, warranties, and covenants made by Grand in this Plan of Merger, and take no action which would cause Grand's representations and warranties to become untrue or incomplete except as and to the extent required by applicable laws and regulations or regulatory agencies having jurisdiction. 5.3.3

Compliance. Comply in all material respects with all laws, regulations, agreements, court orders, and administrative orders applicable to the conduct of their business unless the application of such laws, regulations, or orders is being contested in good faith and the other party has been notified of such contest. 5.3.4 No Amendments. Make no change in their Articles of Incorporation or their Bylaws, except as effected by this Plan of Merger and the Merger. 5.3.5

Books and Records. Maintain their books, accounts, and records in the usual and regular manner, and in material compliance with all applicable laws and accounting standards. 5.3.6 No Change in Stock. Make no change in the number of shares of their capital stock issued and outstanding other than upon exercise of Grand Stock Options; grant no warrant, option, or commitment relating to their capital stock; enter into no agreement relating to their capital stock; and issue no securities convertible into their capital stock. 5.3.7 Maintenance. Use all reasonable efforts to maintain their property and assets in their present state of repair, order and condition, reasonable wear and tear and damage by fire or other casualty excepted. 5.3.8 Preservation of Goodwill. Use all reasonable efforts to preserve their business organization intact, to keep available the services of their present officers and employees, and to preserve the goodwill of their customers and others having business relations with it. 5.3.9 Insurance Policies. Use all reasonable

efforts to maintain and keep in full force and effect insurance coverage, so long as such insurance is reasonably available, on their assets, properties, premises, operations, and personnel in such amounts, against such risks and losses, and with such self-insurance requirements as are presently in force.

5.3.10 Charge-Offs. Charge off loans and maintain their reserve for loan losses, in each case in a manner in conformity with the prior practices of Grand and its subsidiaries and applicable industry, regulator, and accounting standards; provided, however, that in addition to the prior practices of Grand and its subsidiaries, immediately prior to the Effective Time of the Merger, the Bank will charge against its earnings an addition to its loan loss reserve in an amount necessary to bring the Bank's loan loss reserve up to a level comparable with the loan loss reserve level of 1.42% maintained by Macatawa at its subsidiary bank; and provided further that such action by the Bank to increase its loan loss reserve to a level of at least 1.42% irrespective of the Bank's prior practices, shall not result in any breach of any representation, warranty or covenant in this Plan of Merger.

5.3.11 Policies and Procedures. Make no material change in any policies and procedures applicable to the conduct of their business, including without limitation any loan and underwriting policies, loan loss and charge-off policies, investment policies, and employment policies, except as and to the extent required by law or regulatory agencies having jurisdiction.

5.3.12 New Directors or Officers. Except to reelect persons who are then incumbent directors and officers at annual meetings, not: (a) Increase the number of directors or fill any vacancy on the boards of directors; or (b) Elect or appoint any person to an executive office without first consulting Macatawa.

A-23 5.3.13 Compensation and Benefits. (a) Not increase, or agree to increase, the salary or other compensation payable to, or fringe benefits of, or pay or agree to pay any bonus to, any director or officer, or any other class or group of employees as a class or group, except for increases, agreements or payments which are reasonable in amount and consistent with the prior year, annual salary increases as described in the Grand Disclosure Statement and the payment of bonuses that have previously been approved by the Board of Directors of Grand as described in the Grand Disclosure Statement; and (b) Not introduce, change, or agree to introduce or change, any pension, profit sharing, or employee benefit plan, fringe benefit program, or other plan or program of any kind for the benefit of their employees unless required by law or this Plan of Merger, or necessary or advisable, in the opinion of counsel, to maintain any tax qualified status, except as provided in Section 6.8 (Employee Benefit Plans).

5.3.14 New Employment Agreements. Not enter into any employment agreement which is not terminable by Grand or its subsidiaries without cost or penalty upon notice of 30 days or less, except any such agreement which may be approved by Macatawa in writing.

5.3.15 Borrowing. Not borrow money except in the ordinary course of business.

5.3.16 Mortgaging Assets. Not sell, mortgage, pledge, encumber, or otherwise dispose of, or agree to sell, mortgage, pledge, encumber, or otherwise dispose of, any of their property or assets, except in the ordinary course of business and except for property or assets, or any group of related properties or assets, that individually has a fair market value of less than \$25,000, or that collectively have an aggregate fair market value of less than \$75,000.

5.3.17 Notice of Actions. Notify the other party of the threat or commencement of any material action, suit, proceeding, claim, arbitration, or investigation against or relating to: (i) Grand, the Bank or any other subsidiary of Grand; (ii) Grand's, the Bank's or any other subsidiary of Grand's directors, officers, or employees in their capacities as such; (iii) Grand's, the Bank's or any other subsidiary of Grand's assets, liabilities, businesses, or operations; or (iv) the Merger or this Plan of Merger.

5.3.18 New Service Arrangements. Not enter into, or commit to enter into, any agreement for trust, consulting, professional, data processing, or other services to Grand or its subsidiaries which is not terminable by Grand or its subsidiaries without penalty upon notice of 30 days or less, except for renewal of contracts for data processing and other services reasonably believed to be necessary for the conduct of business in the ordinary course and contracts under which the aggregate required payments do not exceed \$25,000, in each case only after consultation with Macatawa.

5.3.19 Capital Improvements. Not open, enlarge, or materially remodel any bank or other facility, and not lease, purchase, or otherwise acquire any real property for use as a branch bank or office, or apply for regulatory approval of any new branch bank, excepting pursuant to prior commitments made by Grand or its subsidiaries that are disclosed in the Grand Disclosure Statement.

5.4 Accrual of Transaction Expenses. Grand and its subsidiaries shall immediately prior to the Effective Time of the Merger accrue and charge against its earnings all transaction expenses which Grand has incurred or will incur as a result of the transactions contemplated by this Plan of Merger (including, without limitation, any retention or change of control payments approved by Macatawa and its legal, accounting, actuarial, tax services, and investment banker's fees). Such accrual and charge shall not constitute a result in a breach of any representation, warranty or covenant in this Plan of Merger.

5.5 Termination of Phantom Stock Plan. Prior to the Effective Time of the Merger, Grand shall terminate the Grand Bank Financial Phantom Stock Plan (the "Phantom

Plan") and pay out all benefits earned under that plan, whether or not then vested, according to the terms of that plan. All expenses related to or caused by the termination of the Phantom Plan, will be accrued and charged against Grand's earnings prior to the Effective Time of the Merger. Such accrual and charge shall not constitute a result in a breach of any representation, warranty or covenant in this Plan of Merger.

5.6 Regular Dividends. Grand shall not declare, set aside, pay or make any dividend or other distribution or payment (whether in cash, stock or property) with respect to, or purchase or redeem, any shares of Grand Common Stock other than regular quarterly cash dividends on Grand Common Stock in an amount not to exceed \$.50 per share per quarter, in each case payable on the regular historical payment dates and in a manner consistent with Grand's past dividend practice. Macatawa A-24 and Grand agree that they will cooperate to assure that, during any calendar quarter, there shall not be either a duplication or an omission of payment of dividends to the holders of Grand Common Stock.

5.7 Affiliates. The Grand Disclosure Statement and the update to the Grand Disclosure Statement shall identify every person who may, to Grand's reasonable knowledge, be deemed to be an "affiliate" of Grand for purposes of Rule 145 under the Securities Act of 1933, as amended (the "Securities Act"). Grand shall cause its counsel to deliver to each person who is identified as an affiliate, on or prior to the Effective Time of the Merger, advice with respect to such person's obligations under the Securities Act and the regulations issued thereunder with respect to disposition of securities of Macatawa. Further, Grand shall use all reasonable efforts to cause each person who is identified as an affiliate to deliver to Macatawa on or prior to the Effective Time of the Merger a written agreement, reasonably satisfactory to Macatawa, that such person shall not offer to sell or otherwise dispose of any shares of Macatawa Common Stock beneficially owned by or issued to such person pursuant to the Merger in violation of the Securities Act or the regulations thereunder.

5.8 Approval of Plan of Merger by Macatawa Shareholders. Macatawa, acting through its Board of Directors, shall, in accordance with the Michigan Act and its Articles of Incorporation and Bylaws, promptly and duly call, give notice of, convene, and hold as soon as practicable following the date upon which the Registration Statement becomes effective, a shareholders meeting for the purpose of adopting this Plan of Merger and the issuance of the shares of Macatawa Common Stock pursuant to the Merger (the "Macatawa Shareholders' Meeting"). At such meeting, the Board of Directors of Macatawa shall unanimously recommend that its shareholders vote for approval of this Plan of Merger and the issuance of the shares of Macatawa Common Stock pursuant to the Merger and use all reasonable efforts to solicit from its shareholders proxies to vote on the proposal to approve this Plan of Merger and the issuance of such shares and to secure a quorum at such meeting.

5.9 Approval of Plan of Merger by Grand Shareholders. Grand, acting through its Board of Directors, or a duly authorized committee shall, in accordance with the Michigan Act and its Articles of Incorporation and Bylaws, promptly and duly call, give notice of, convene, and hold as soon as practicable following the date upon which the Registration Statement becomes effective, a shareholders meeting for the purpose of adopting this Plan of Merger (the "Grand Shareholders' Meeting").

5.9.1 Board Recommendation. Except while Grand has received in writing a Superior Proposal (as defined in Section 5.9.4 (Superior Proposal)), which proposal is still pending, at the Grand Shareholders' Meeting and in any proxy materials used in connection with the Grand Shareholders' Meeting, the Board of Directors of Grand shall recommend that its shareholders vote for approval of this Plan of Merger.

5.9.2 Solicitation of Proxies. Except after the occurrence of a Fiduciary Event and while such event continues: (a) Grand shall use all reasonable efforts to solicit from its shareholders proxies to vote on the proposal to approve this Plan of Merger and to secure a quorum at the Grand Shareholders' Meeting. (b) Except while Grand has received in writing a Superior Proposal that is still pending, Grand shall use all reasonable efforts to secure the vote of shareholders required by the Michigan Act and Grand's Articles of Incorporation and Bylaws to approve this Plan of Merger.

5.9.3 Fiduciary Event. A "Fiduciary Event" shall have occurred when the Board of Directors of Grand has (a) received in writing a Superior Proposal (as defined in Section 5.9.4 (Superior Proposal)) that is then pending, (b) determined in good faith (having considered the advice of legal counsel) that its fiduciary duties to Grand's shareholders under applicable law would require the Board of Directors to so withdraw, modify, or change its recommendation, and (c) determined to accept and recommend the Superior Proposal to the shareholders of Grand.

5.9.4 Superior Proposal. A "Superior Proposal" means any bona fide unsolicited Acquisition Proposal (as defined in Section 5.10.1 (No Solicitation)) made by a third party on terms that the Board of Directors of Grand determines in its good faith judgment, (having considered the written advice of Austin Associates or another financial advisor of recognized reputation) to be materially more favorable to Grand's shareholders than this Plan of Merger from a financial point of view.

5.9.5 Notice. Grand shall notify Macatawa at least ten business days prior to taking any action with respect to such Superior Proposal or taking any action with respect to the withdrawal, modification, or change of

its recommendation to its shareholders for adoption of this Plan of Merger. A-25

5.10 Competing Proposals. Except as provided below, neither Grand nor its subsidiaries, nor any of their respective directors, officers, employees, investment bankers, representatives, or agents, shall take any action inconsistent with the intent to consummate the Merger upon the terms and conditions of this Plan of Merger. Without limiting the foregoing:

5.10.1 No Solicitation. Neither Grand nor its subsidiaries, nor any of their respective directors, officers, employees, attorneys, investment bankers, representatives, or agents, shall, directly or indirectly, (i) invite, initiate, solicit, or encourage an Acquisition Proposal or (ii) participate in any discussions or negotiations regarding an Acquisition Proposal unless a Fiduciary Event has occurred and continues or such discussions or negotiations are likely to lead to a Superior Proposal. A proposal, offer, or other expression of interest concerning any tender offer, exchange offer, merger, consolidation, sale of shares, sale of assets, or assumption of liabilities not in the ordinary course, or other business combination involving Grand or its subsidiaries, or substantially all of their respective assets or properties, other than the Merger shall be referred to as an "Acquisition Proposal".

5.10.2 Communication of Other Proposals. Grand shall cause written notice to be delivered to Macatawa promptly upon receipt of any Acquisition Proposal. Such notice shall contain the material terms and conditions of the Acquisition Proposal to which such notice relates. Within ten business days after Grand's receipt of an Acquisition Proposal, Grand shall give notice to Macatawa whether or not a Fiduciary Event has occurred or a Superior Proposal is reasonably likely to result, and if not, Grand's notice shall include a copy of Grand's unequivocal rejection of the Acquisition Proposal in the form actually delivered to the person from whom the Acquisition Proposal was received. Thereafter, Grand shall promptly notify Macatawa of any material changes in the terms, conditions, and status of such Acquisition Proposal.

5.10.3 Furnishing Information. Unless a Fiduciary Event has occurred and continues or there is reasonable likelihood that a Superior Proposal would result, neither Grand nor its subsidiaries, nor any of their respective directors, officers, employees, attorneys, investment bankers, representatives, or agents, shall furnish any nonpublic information concerning Grand or its subsidiaries to any person who is not affiliated or under contract with Grand or Macatawa, except as required by applicable law or regulations. Prior to furnishing such information to any person who is not affiliated or under contract with Grand or Macatawa, Grand shall receive from such person an executed confidentiality agreement with terms no less favorable to Grand than those contained in its confidentiality agreement with Macatawa, and Grand shall then provide only such information as has been furnished previously to Macatawa.

5.10.4 Payment after Certain Events. If, after this Plan of Merger is executed, the Board of Directors of Grand or the shareholders of Grand accept or approve any Acquisition Proposal or Superior Proposal, which competes or is otherwise inconsistent with the transactions contemplated by this Plan of Merger or terminates this Plan of Merger due to a Fiduciary Event, then Grand shall promptly pay to Macatawa a fee of \$2,000,000.

5.10.5 Corporate Liability for Individual's Breach. For the purposes of this Section 5.10 (Competing Proposals), any breach of this Section 5.10 (Competing Proposals) or of any subsection hereof by an executive officer, director, attorney or financial advisor of Grand, in his or her individual capacity, shall be deemed to be a breach by Grand. Notwithstanding the above, no provision of this Plan of Merger shall be construed to require either party or their directors to take any action that would violate applicable law (whether statutory or common law), rule, or regulation.

5.11 Indemnification. Macatawa shall honor any and all rights to indemnification and advancement of expenses now existing in favor of the present and former directors and officers of Grand, the Bank, or the Mortgage Company under their Articles of Incorporation or Bylaws included in the Grand Disclosure Statement, which shall survive the Merger as enforceable contractual rights, and shall, as contractual rights, continue with respect to acts or omissions occurring before the Effective Time of the Merger with the same force and effect as prior to the Effective Time of the Merger. This Section 5.11 (Indemnification) is for the benefit of persons who are or have been directors or officers of Grand and shall be enforceable by and only by such persons and their estates and personal representatives.

5.12 Insurance. Macatawa shall use all reasonable efforts to cause the persons currently serving or having served as officers and directors of Grand immediately prior to the Effective Time of the Merger to be covered for a period of at least six years from the Effective Time of the Merger by the directors' and officers' liability insurance policy ("D&O Policy") maintained by Grand (provided that Macatawa may substitute for such Grand D&O Policy a substitute D&O Policy of at least the same coverage and amounts as Macatawa provides to its own officers and directors) with respect to acts or omissions occurring prior to the Effective Time of the Merger that were committed by such officers and directors in their capacity as such. In no event shall Macatawa be required to spend, directly or indirectly, more than \$96,000 in the aggregate to either A-26 maintain or provide insurance coverage pursuant to this Plan of Merger. If Macatawa does not advise Grand in writing prior to the Grand Shareholders' Meeting that it has procured such

coverage, Grand shall be permitted (after giving Macatawa three business days prior written notice and an additional two business day period to purchase such coverage), in lieu of receiving the foregoing insurance coverage, to procure tail coverage for past acts and omissions for a single premium amount not in excess of \$96,000. This Section 5.12 (Insurance) is for the benefit of persons who are or have been directors or officers of Grand and shall be enforceable by and only by such persons and their estates and personal representatives. 5.13 Name. After the Effective Time of the Merger, Macatawa agrees that it shall retain and use the "Grand" name and charter for a period of at least two (2) years from the Effective Time of the Merger, unless the Board of Directors of the Bank agrees otherwise. 5.14 Charitable Giving. Notwithstanding Section 5.3 (Conduct of Business Pending the Effective Time of the Merger) Grand and Bank shall be permitted to make charitable contributions, authorized by their respective boards of directors, with respect to Grand's 2001 fiscal year (some of which will be payable in 2002) in an amount equal to 10% of pretax profits for 2001, provided such charitable contributions are properly accrued as an expense for the year ended on or before December 31, 2001. Macatawa agrees to work with the Board of Directors of the Bank to develop an appropriate community-giving plan for the Bank to be implemented after the Effective Time of the Merger. ARTICLE VI ADDITIONAL AGREEMENTS 6.1 Registration Statement. As soon as is reasonably practical, Macatawa agrees to prepare and file with the SEC under the Securities Act the Registration Statement and the related Prospectus and Proxy Statement included as a part thereof covering the issuance by Macatawa of the shares of Macatawa Common Stock as contemplated by this Plan of Merger, together with such amendments as may reasonably be required for the Registration Statement to become effective. Macatawa agrees to provide Grand with the opportunity to review and comment upon the Registration Statement, each amendment to the Registration Statement, and each form of the Prospectus and Proxy Statement before filing. Macatawa agrees to provide Grand with copies of all correspondence received from the SEC with respect to the Registration Statement and its amendments and with all responsive correspondence to the SEC. Macatawa agrees to notify Grand of any stop orders or threatened stop orders with respect to the Registration Statement. Grand agrees to provide all necessary information pertaining to Grand and its subsidiaries promptly upon request, and to use all reasonable efforts to obtain the cooperation of Grand's independent accountants and attorneys, in connection with the preparation of the Registration Statement. 6.2 Other Filings. Macatawa agrees to prepare and file, as soon as is reasonably practical, with the Federal Reserve Board, the State of Michigan, and any other appropriate regulatory agencies all documents in connection with the transactions contemplated by this Plan of Merger. Macatawa agrees to provide Grand with the opportunity to review and comment upon such documents before filing, to make such amendment and file such supplements thereto as Macatawa may reasonably request, and to provide Grand with copies of all correspondence received from these agencies and all responsive correspondence sent to these agencies. 6.3 Press Releases. Grand and Macatawa shall cooperate with each other in the development and distribution of all news releases and other public information disclosures with respect to this Plan of Merger, except as may be otherwise required by law. Neither Grand nor Macatawa shall issue any news releases with respect to this Plan of Merger or the Merger unless such news releases have been mutually agreed upon by the parties, except as required by law. 6.4 Miscellaneous Agreements and Consents. Subject to the terms and conditions of this Plan of Merger, each of the parties agrees to use all reasonable efforts to take, or cause to be taken, all actions and to do, or cause to be done, all things necessary, proper, or advisable under applicable laws and regulations to consummate and make effective the transactions contemplated by this Plan of Merger. Macatawa and Grand will use reasonable efforts to obtain consents of all third parties and governmental bodies necessary or desirable for the consummation of the Merger. 6.5 Financial Information. Subject to Section 6.6 (Investigation), after the date of the execution of this Plan of Merger until the Effective Time of the Merger, each party shall promptly deliver to the other party copies of: (a) Each monthly internal financial report (if any) prepared with respect to Grand or Macatawa, as applicable, and its subsidiaries on a consolidated or unconsolidated basis; and (b) Each financial report or statement submitted to regulatory authorities for Grand or Macatawa, as applicable, and/or any subsidiary. A-27 6.6 Investigation. 6.6.1 Access to Information by Macatawa. For the purpose of permitting an examination of Grand by such of Macatawa's officers, attorneys, accountants, and representatives for the purposes of Macatawa's evaluation of the Merger, Grand shall: (a) Permit, and shall cause the Bank and all other subsidiaries of Grand to permit, full access to their respective properties, books, and records at reasonable times; (b) Use reasonable efforts to cause its and the Bank's directors, officers, employees, accountants, and attorneys and those of all subsidiaries of Grand to cooperate fully, for the purpose of permitting a complete and detailed examination of such matters by Macatawa's officers, attorneys, accountants, and representatives; (c) Furnish to Macatawa, upon request, any information reasonably

requested respecting Grand's and any of its subsidiaries' properties, assets, business, and affairs; and (d) Permit representatives of Macatawa to attend meetings of the Board of Directors and committees of the boards of directors of Grand and its subsidiaries; provided, however, that representatives of Macatawa will excuse themselves during discussion of this Plan of Merger and the transactions contemplated hereby and during discussion of matters that the Board of Directors of Grand reasonably believes to be of competitive significance.

6.6.2 Access to Information by Grand. For the purposes of permitting an examination of Macatawa by such of Grand's officers, attorneys, accountants, and representatives for the purposes of Grand's evaluation of the Merger, Macatawa shall permit access to such of Macatawa's and its subsidiaries books and records and at such times as reasonably and mutually agreed between the President of each of Macatawa and Grand.

6.6.3 Consent to Disclose. Macatawa and Grand each acknowledge that certain information may not be disclosed by Macatawa or Grand or their subsidiaries without the prior written consent of persons not affiliated with Macatawa or Grand. If such information is requested by Macatawa or Grand, then the other party shall use, or cause its subsidiaries to use, reasonable efforts to obtain such prior consent and shall not be required to disclose such information unless and until such prior consent has been obtained.

6.6.4 Confidentiality. Except as provided in Section 6.6.6 (Other Information), while this Plan of Merger is in effect and at all times thereafter, Macatawa and Grand each agree to treat as strictly confidential and agree not to divulge to any other person, natural or corporate (other than employees of, and attorneys, accountants, and financial advisers for, such party who are reasonably believed to have a need for such information in connection with the Merger), and not to make any business use not related to the Merger of, any financial statements, schedules, contracts, agreements, instruments, papers, documents, or other information relating to the other party and the other party's subsidiary(ies) which it may come to know as a direct result of a disclosure by the other party or the other party's subsidiary(ies), or which may come into its possession directly as a result of and during the course of such investigation. Macatawa and Grand recognize and understand the close proximity of their respective markets and agree that the fact that a party to this Plan of Merger is or begins doing business with a customer of the other party will not be presumed to be a breach of the provisions of this Section 6.6.4 (Confidentiality).

6.6.5 Return of Materials. Upon the termination of this Plan of Merger, Macatawa and Grand each agree to promptly return to the other party or to destroy all written materials furnished to it by the other party and the other party's subsidiary(ies), and all notes and summaries of such written materials, in connection with such investigation, including any and all copies of any of the foregoing. Macatawa and Grand each agree to preserve intact all such materials which are returned to them and to make such materials reasonably available upon request or subpoena for a period of not less than five years from the termination of this Plan of Merger or such longer or shorter period of time as they may mutually agree.

6.6.6 Other Information. The provisions of this Section 6.6 (Investigation) shall not preclude Macatawa or Grand, or their respective subsidiaries, from using or disclosing information which is: (i) readily ascertainable from public information or trade sources; (ii) known by it before the commencement of discussions between the parties or subsequently developed by it or its subsidiaries independent of any investigation under this Plan of Merger or received A-28 from a third party not under any obligation to Grand or Macatawa, or their respective subsidiaries, to keep such information confidential; or (iii) reasonably required to be included in any filing or application required by any governmental or regulatory agency, including without limitation Macatawa's application or applications to the Federal Reserve Board, and Macatawa's or Grand's annual report and proxy statement. Macatawa shall permit Grand to review Macatawa's application or applications to the Federal Reserve Board prior to filing and Grand may reasonably request that sensitive or competitive information be separately filed as confidential in accordance with instructions, rules, and regulations issued by such agency.

6.6.7 Insider Trading. Grand and Macatawa shall take responsible steps to assure that any person who receives nonpublic information concerning Macatawa or Grand pursuant to this Plan of Merger will not buy or sell, or advise other persons to buy or sell, Macatawa Common Stock or Grand Common Stock until such information is disclosed to the public.

6.7 Environmental Investigation. Macatawa may, at its own option and expense, engage environmental consultants to conduct a preliminary ("Phase I") environmental assessment of any parcel of real estate owned and used in the operation of Grand's or its subsidiaries' businesses and any other real estate owned. Grand and its subsidiaries shall provide reasonable assistance, including site access, to such a consultant for purposes of conducting the Phase I assessments. The fees and expenses of a consultant with respect to the Phase I assessments shall be paid by Macatawa, subject to the provisions of Section 10.5 (Expenses). If any environmental conditions are found, reasonably suspected, or would tend to be indicated by the report of the consultant which may be contrary to the representations and warranties set forth in Section 4.21 (Environmental Matters), without regard to any exceptions

that may be contained in the Grand Disclosure Statement, then Macatawa shall obtain from one or more mutually acceptable consultants or contractors, as appropriate, an estimate of the cost of any further environmental investigation, sampling, analysis, remediation, or other follow-up work that may be necessary to address those conditions in accordance with applicable Environmental Laws. Macatawa shall forward copies of any such estimates to Grand upon receipt.

6.7.1 Mutual Agreement. Upon receipt of the estimate of the costs of all follow-up work to the Phase I assessments or any subsequent investigation phases that may be conducted, the parties shall attempt to agree upon a course of action for further investigation and remediation of any environmental condition suspected, found to exist, or that would tend to be indicated by the report of the consultant. All work plans for any post-Phase I assessment activities, or any removal or remediation actions that may be performed, shall be mutually satisfactory to Macatawa and Grand. If the work plans or removal or remediation actions would entail a material cost to complete, Macatawa and Grand shall discuss a mutually acceptable modification to this Plan of Merger. Macatawa and Grand shall cooperate in the review, approval, and implementation of all work plans.

6.7.2 Right to Abandon. If the parties are unable to agree upon a course of action for further investigation and remediation of an environmental condition or issue raised by an environmental assessment and/or a mutually acceptable modification to this Plan of Merger, and the condition or issue is not one for which it can be determined to a reasonable degree of certainty that the risk and expense to which Macatawa and its subsidiaries (after the Merger) would be subject as owner or operator of the property involved can be quantified and limited to an amount which would not have a Material Adverse Effect on the business or financial condition of Grand and its subsidiaries on a consolidated basis, then Macatawa may abandon this Plan of Merger pursuant to Section 9.3.3 (Environmental Risk).

6.8 Employee Benefit Plans. The Grand Pension Plan will be frozen as of the Effective Time of the Merger, so that there shall be no further accrual of benefits under the Grand Pension Plan after such time. Simultaneously with or in anticipation of freezing of the Grand Pension Plan, Grand will amend the Grand Benefit Restoration Plan to provide that the restored benefit under that plan includes the portion of any accrued benefit under the Grand Pension Plan that is not vested when benefit accruals are frozen and does not later vest due to termination of the Grand Pension Plan. Macatawa expressly reserves the right to terminate the Grand Pension Plan at any time it so chooses after the Effective Time of the Merger. The Grand 401(k) Plan will be merged into or combined with the Macatawa Bank 401(k) Plan at such time after the Effective Time of the Merger and in such manner as determined by Macatawa.

ARTICLE VII CONDITIONS PRECEDENT TO MACATAWA'S OBLIGATIONS All obligations of Macatawa under this Plan of Merger are subject to the fulfillment (or waiver in writing by a duly authorized officer of Macatawa), prior to or at the Closing, of each of the following conditions:

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7.1 Renewal of Representations and Warranties, Etc.

7.1.1 Representations and Warranties. Grand's representations and warranties shall then be true in all material respects or, if one or more representations or warranties shall then be untrue or incomplete, the cumulative effect of all untrue or incomplete representations and warranties shall not then be materially adverse relative to the business, income, financial condition or prospects of Grand and its subsidiaries on a consolidated basis. For purposes of this Section 7.1.1 (Representations and Warranties), representations and warranties made with respect to specified dates or events need only to have been true in all material respects as of such dates or events. Any representation or warranty which becomes untrue because of any change intended by this Plan of Merger shall not be considered to be a breach of this Plan of Merger because of such change.

7.1.2 Compliance with Agreements. Grand and its subsidiaries shall have performed and complied with all agreements, conditions, and covenants required by this Plan of Merger to be performed or complied with by Grand or its subsidiaries prior to or at the Closing in all material respects.

7.1.3 Certificates. Compliance with Sections 7.1.1 (Representations and Warranties) and 7.1.2 (Compliance with Agreements) shall be evidenced by one or more certificates signed on behalf of Grand by appropriate officers of Grand and, with respect to agreements, conditions, and covenants pertaining to its subsidiaries, by appropriate officers of its subsidiaries, dated as of the date of the Closing, certifying the foregoing in such detail as Macatawa may reasonably request, and describing any exceptions to such compliance in such certificates.

7.2 Opinion of Legal Counsel. Grand shall have delivered to Macatawa an opinion of its counsel consistent with Appendix A, dated as of the date of the Closing and reasonably satisfactory to counsel for Macatawa.

7.3 Required Approvals. Macatawa shall have received:

7.3.1 Regulatory. All such approvals, consents, authorizations, and licenses of all regulatory and other governmental authorities having jurisdiction as may be required to permit the performance by Grand and Macatawa of their respective obligations under this Plan of Merger and the consummation of the Merger.

7.3.2 Shareholder. The requisite approval of the Macatawa shareholders of this Plan of Merger and the Merger and evidence reasonably satisfactory to Macatawa of the requisite approval of

Grand's shareholders of this Plan of Merger and the Merger. 7.4 Order, Decree, Etc. Neither Macatawa nor Grand shall be subject to any order, decree or injunction of a court or agency of competent jurisdiction which enjoins or prohibits the consummation of the Merger. 7.5 Proceedings. There shall not be any action, suit, proceeding, claim, arbitration, or investigation pending or threatened: (i) against Grand or its subsidiaries or their respective properties or businesses which may result in any liability to either of them or its subsidiaries which could have a Material Adverse Effect on the financial condition, net income, business, or properties of Grand and its subsidiaries on a consolidated basis; or (ii) which challenges the Merger or this Plan of Merger. 7.6 Tax Matters. Macatawa shall have received an opinion of Varnum, Riddering, Schmidt & Howlett LLP, reasonably satisfactory in form and substance, substantially to the effect that: 7.6.1 Reorganization. The Merger of Grand with and into Macatawa will constitute a reorganization within the meaning of Section 368(a)(1)(A) of the Internal Revenue Code, and Macatawa and Grand will each be a "party to a reorganization" within the meaning of Section 368(b) of the Internal Revenue Code. 7.6.2 Assets' Tax Basis. The basis of the Grand assets in the hands of Macatawa immediately after the Merger will be the same as the basis of those assets in the hands of Grand immediately prior to the Merger. 7.6.3 No Gain or Loss. No gain or loss will be recognized to Macatawa on the receipt by Macatawa of the assets of Grand in exchange for Macatawa Common Stock and the assumption by Macatawa of the liabilities of Grand. 7.6.4 Holding Period. The holding period of the assets of Grand in the hands of Macatawa will include the holding period during which Grand held such assets. A-30 The tax opinion shall be supported by one or more fact certificates or affidavits in such form and content as may be reasonably requested by Macatawa's counsel from Grand and its subsidiaries and Macatawa and its subsidiaries. 7.7 Registration Statement. The Registration Statement shall have been declared effective by the SEC and shall not be subject to a stop order or any threatened stop order. 7.8 Certificate as to Outstanding Shares. Macatawa shall have received one or more certificates signed by the secretary of Grand on behalf of Grand, certifying the total number of shares of capital stock of Grand issued and outstanding as of the close of business on the day immediately preceding the Closing, all in such form as Macatawa may reasonably request. 7.9 Change of Control Waivers. Macatawa shall have received evidence of the waiver of any material rights and the waiver of the loss of any material rights which may be triggered by the change of control of Grand upon consummation of the Merger under any agreements, contracts, mortgages, deeds of trust, leases, commitments, indentures, notes, or other instruments, all in form and substance reasonably satisfactory to Macatawa. 7.10 Employment Agreements. The Amended and Restated Employment Agreements described in the Grand Disclosure Statement shall have been executed and shall not have been terminated, cancelled or amended. 7.11 Grand Stock Options. There shall not have been any issuances of Grand Stock Options since the date of this Plan of Merger. 7.12 Amendment of Grand Stock Options. Grand shall have amended its stock option plans or caused the written amendment of each outstanding Grand Stock Option grant prior to the Closing if and to the extent necessary to permit the conversion of the outstanding Grand Stock Options as contemplated by Section 2.2 (Conversion of Grand Stock Options). 7.13 Fairness Opinion. Macatawa shall have received an opinion reasonably acceptable to Macatawa, dated as of the date of this Plan of Merger and renewed as of a date approximately the date of the Prospectus and Proxy Statement, that the terms of the Merger are fair to Macatawa's shareholders from a financial standpoint as of that date and such opinion shall not have been subsequently withdrawn; provided, that Macatawa shall have used all reasonable efforts to obtain such a fairness opinion.

ARTICLE VIII CONDITIONS PRECEDENT TO GRAND'S OBLIGATIONS All obligations of Grand under this Plan of Merger are subject to the fulfillment (or waiver in writing by a duly authorized officer), prior to or at the Closing, of each of the following conditions: 8.1 Renewal of Representations and Warranties, Etc. 8.1.1 Representations and Warranties. Macatawa's representations and warranties shall then be true in all material respects or, if one or more representations or warranties shall then be untrue, the cumulative effect of all untrue representations and warranties shall not then be materially adverse relative to the business, income, or financial condition of Macatawa and its subsidiaries on a consolidated basis. For purposes of this Section 8.1.1 (Representations and Warranties), representations and warranties made with respect to specified dates or events need only to have been true in all material respects as of such dates or events. Any representation or warranty which becomes untrue because of any change intended by this Plan of Merger shall not be considered to be a breach of this Plan of Merger because of such change. 8.1.2 Compliance with Agreements. Macatawa and its subsidiaries shall have performed and complied with all agreements, conditions, and covenants required by this Plan of Merger to be performed or complied with by Macatawa and its subsidiaries prior to or at the Closing in all material respects. 8.1.3 Certificates. Compliance with Sections 8.1.1 (Representations and Warranties) and 8.1.2 (Compliance with Agreements) shall be evidenced by one

or more certificates signed on behalf of Macatawa by the appropriate officers of Macatawa and, with respect to agreements, conditions, and covenants pertaining to its subsidiaries, by appropriate officers of its subsidiaries, dated as of the date of the Closing, certifying the foregoing in such detail as Grand may reasonably request, and describing any exceptions to such compliance in such certificates. A-31 8.2 Opinions of Legal Counsel. Macatawa shall have delivered to Grand an opinion of its counsel consistent with Appendix B, dated as of the date of the Closing and reasonably satisfactory to counsel for Grand. 8.3 Required Approvals. Grand shall have received: 8.3.1 Regulatory. Grand and Macatawa shall have received all such approvals, consents, authorizations, and licenses of all regulatory and other governmental authorities having jurisdiction as may be required to permit the performance by Grand and Macatawa, or their subsidiaries, of their respective obligations under this Plan of Merger and the consummation of the Merger. 8.3.2 Shareholder. The Grand shareholders shall have approved this Plan of Merger and Grand shall have received evidence reasonably satisfactory to Grand of the requisite approval of the Macatawa shareholders of this Plan of Merger and the Merger. 8.4 Order, Decree, Etc. Neither Macatawa nor Grand shall be subject to any order, decree or injunction of a court or agency of competent jurisdiction which enjoins or prohibits the consummation of the Merger. 8.5 Proceedings. There shall not be any action, suit, proceeding, claim, arbitration, or investigation pending or threatened: (i) against or relating to either Grand or Macatawa or their respective subsidiaries or their respective properties or businesses which may result in any liability to either of them or its subsidiaries which could have a Material Adverse Effect on the financial condition, net income, business, properties, operations, or prospects of either of them and its subsidiaries on a consolidated basis; or (ii) which challenges the Merger or this Plan of Merger. 8.6 Tax Matters. Grand shall have received an opinion from Varnum, Riddering Schmidt & Howlett LLP, reasonably satisfactory in form and substance, substantially to the effect that: 8.6.1 Reorganization. The Merger of Grand with and into Macatawa will constitute a reorganization within the meaning of Section 368(a)(1)(A) of the Internal Revenue Code, and Macatawa and Grand will each be a "party to a reorganization" within the meaning of Section 368(b) of the Internal Revenue Code. 8.6.2 No Gain or Loss. No gain or loss will be recognized by the shareholders of Grand who receive shares of Macatawa Common Stock in exchange for all of their shares of Grand Common Stock, except to the extent of any cash received in lieu of a fractional share of Macatawa Common Stock. 8.6.3 Stock Tax Basis. The basis of the Macatawa Common Stock to be received by shareholders of Grand will, in each instance, be the same as the basis of the respective shares of Grand Common Stock surrendered in exchange therefor. 8.6.4 Holding Period. The holding period of the Macatawa Common Stock received by shareholders of Grand will, in each instance, include the period during which the Grand Common Stock surrendered in exchange therefor was held, provided that the Grand Common Stock was, in each instance, held as a capital asset in the hands of the shareholder of Grand at the Effective Time of the Merger. 8.7 Registration Statement. The Registration Statement shall have been declared effective by the SEC and shall not be subject to a stop order or any threatened stop order. 8.8 Listing of Shares. The shares of Macatawa Common Stock that shall be issued to the shareholders of Grand upon consummation of the Merger shall have been authorized for listing on The NASDAQ Stock Market upon official notice of issuance. 8.9 Certificate as to Outstanding Shares. Grand shall have received one or more certificates signed by Macatawa's transfer agent and the secretary of Macatawa on behalf of Macatawa, certifying the total number of shares of capital stock of Macatawa issued and outstanding as of the close of business on the day immediately preceding the Closing, all in such form as Grand may reasonably request. 8.10 Fairness Opinion. Grand shall have received an opinion acceptable to Grand, dated as of the date of this Plan of Merger and renewed as of a date approximately the date of the Prospectus and Proxy Statement, that the financial terms of the Merger are fair to Grand's shareholders from a financial standpoint as of that date and such opinion shall not have been subsequently withdrawn; provided, that Grand shall have used all reasonable efforts to obtain such a fairness opinion. A-32 ARTICLE IX ABANDONMENT OF MERGER This Plan of Merger may be terminated and the Merger abandoned at any time prior to the Effective Time of the Merger (notwithstanding that approval of this Plan of Merger by the shareholders of Grand and Macatawa may have previously been obtained) as follows: 9.1 Mutual Abandonment. By mutual consent of the boards of directors, or duly authorized committees thereof, of Macatawa and Grand. 9.2 Upset Date. By either Macatawa or Grand if the Merger shall not have been consummated on or before June 30, 2002 and such failure to consummate the Merger is not caused by a breach of this Plan of Merger by the terminating party. 9.3 Macatawa's Rights to Terminate. By Macatawa under any of the following circumstances: 9.3.1 Failure to Satisfy Closing Conditions. If any of the conditions specified in Article VII have not been met or waived by Macatawa, at such time as such condition can no longer be satisfied notwithstanding Grand's reasonable efforts to comply with those covenants and satisfy those

conditions by Grand in this Plan of Merger. 9.3.2 Shareholder Approval. This Plan of Merger is not approved by the requisite vote of the shareholders of Grand or Macatawa at a meeting duly called and held for that purpose at which a quorum is present and voted in person or by proxy and such meeting has been finally adjourned. 9.3.3 Environmental Risks. If Macatawa has given Grand notice of termination based on an unacceptable Environmental Risk, as provided in Section 6.7.2 (Right to Abandon). 9.3.4 Occurrence of a Fiduciary Event. At any time after there has occurred a Fiduciary Event. 9.3.5 Material Adverse Event. If there shall have occurred one or more events that shall have caused or are reasonably likely to cause a Material Adverse Effect on Grand. 9.3.6 Community Reinvestment Act Rating. If, prior to the Closing, the Bank is examined for compliance with the Community Reinvestment Act and receives a rating lower than "Satisfactory" or, if the report of examination is still pending on the date of the Closing, Macatawa is unable to satisfy itself that the Bank will receive a rating of Satisfactory or better. 9.4 Grand's Rights to Terminate. By the Board of Directors, or a duly authorized committee thereof, of Grand under any of the following circumstances: 9.4.1 Failure to Satisfy Closing Conditions. If any of the conditions specified in Article VIII have not been met or waived by Grand at such time as such condition can no longer be satisfied notwithstanding Macatawa's reasonable efforts to comply with those covenants given by Macatawa in this Plan of Merger. 9.4.2 Shareholder Approval. This Plan of Merger is not approved by the requisite vote of the shareholders of Grand or Macatawa at a meeting duly called and held for that purpose at which a quorum is present and voted in person or by proxy and such meeting has been finally adjourned. 9.4.3 Community Reinvestment Act Rating. If, prior to the Closing, any of the banking subsidiaries of Macatawa is examined for compliance with the Community Reinvestment Act and receives a rating lower than "Satisfactory" or, if the report of examination is still pending on the date of the Closing, Grand is unable to satisfy itself that such bank or banks will receive a rating of Satisfactory or better. 9.4.4 Material Adverse Event. If there shall have occurred one or more events that shall have caused or are reasonably likely to cause a Material Adverse Effect on Macatawa. 9.5 Effect of Termination. In the event of termination of this Plan of Merger by either Grand or Macatawa as provided in this Article IV (Abandonment of Merger), this Plan of Merger shall forthwith have no effect, and none of Grand, A-33 Macatawa, any of their respective subsidiaries, or any of their respective directors, officers, or employees shall have any liability of any nature whatsoever under this Plan of Merger, or in connection with the transactions contemplated by this Plan of Merger, except that (a) Sections 5.10.4 (Payment after Certain Events), 6.6.4 (Confidentiality), 6.6.5 (Return of Materials), 10.3 (Nonsurvival of Representations, Warranties, and Agreements), and 10.5 (Expenses) shall survive any termination of this Plan of Merger, and (b) notwithstanding anything to the contrary contained in this Plan of Merger, neither Grand nor Macatawa shall be relieved or released from any of its liabilities or damages arising out of a knowing or intentional breach of a representation and warranty or a breach of any other provision of this Plan of Merger. ARTICLE X MISCELLANEOUS Subject to the terms and conditions of this Plan of Merger, Macatawa and Grand further agree as follows: 10.1 "Material Adverse Effect" Defined. As used in this Plan of Merger, the term "Material Adverse Effect" means any change or effect that, individually or when taken together with all other such changes or effects that have occurred prior to the date of determination of the occurrence of the Material Adverse Effect, has had or could have a material negative impact on (a) the business, assets, financial condition, results of operations, or value of Macatawa and its subsidiaries, taken as a whole, or Grand and its subsidiaries, taken as a whole, as the case may be; or (b) the ability of Macatawa or Grand, as the case may be, to satisfy the applicable closing conditions or consummate the Merger. Notwithstanding the above, the impact of the following shall not be included in any determination of a Material Adverse Effect: (a) changes in GAAP, generally applicable to financial institutions and their holding companies; (b) actions and omissions of a party (or any of its subsidiaries) taken with the prior written consent of the other party; (c) changes in economic conditions (including changes in the level of interest rates) generally affecting financial institutions; and (d) fees and expenses reasonably related to this transaction (such as any additional insurance coverages, employment and consulting services, legal, accounting, and investment banking fees and expenses, and severance and retention provisions) incurred or paid without violation of the representations, warranties or covenants contained in this Plan of Merger. 10.2 "Knowledge" Defined. As used in this Plan of Merger, the term "knowledge" means the actual knowledge of any director or officer (as that term is defined in Rule 16a-1 of the Exchange Act) of Grand or Macatawa, as the case may be. 10.3 Nonsurvival of Representations, Warranties, and Agreements. None of the representations, warranties, covenants, and agreements in this Plan of Merger or in any other agreement or instrument delivered pursuant to this Plan of Merger, including any rights arising out of any breach of such representations, warranties, covenants, and agreements, shall survive the Effective Time of the Merger, except for those covenants and agreements contained

herein that, by the terms hereof, apply or are to be performed in whole or in part after the Effective Time of the Merger. 10.4 Amendment. Subject to applicable law, this Plan of Merger may be amended, modified, or supplemented by, and only by, written agreement of Macatawa and Grand, executed by the respective officers thereunto duly authorized, at any time prior to the Effective Time of the Merger. 10.5 Expenses. Except as otherwise provided in this Plan of Merger, Grand and Macatawa shall each pay its own expenses incident to preparing for, entering into, and carrying out this Plan of Merger, and incident to the consummation of the Merger. Each party shall pay the fees and expenses of any investment banker engaged by that party. The costs of all filing fees pertaining to the Registration Statement shall be paid by Macatawa. The costs of printing and mailing the Prospectus and Proxy Statement to their respective shareholders shall be borne by Macatawa and by Grand respectively. 10.6 Specific Enforcement. The parties each agree that, consistent with the terms and conditions of this Plan of Merger, in the event of a breach by a party to this Plan of Merger, money damages will be inadequate and not susceptible of computation because of the unique nature of Grand, the subsidiaries of Grand, and the Merger. Therefore, the parties each agree that a federal or state court of competent jurisdiction shall have authority, subject to the rules of law and equity, to specifically enforce the provisions of this Plan of Merger by injunctive order or such other equitable means as may be determined in the court's discretion. 10.7 Jurisdiction; Jury. The parties acknowledge that jurisdiction and venue may be permissible in more than one jurisdiction or court district. Macatawa and Grand each hereby agree not to assert any defense of improper jurisdiction or venue and each waive their right to a trial by jury. 10.8 Waiver. Any of the terms or conditions of this Plan of Merger may be waived in writing at any time by action taken by the Board of Directors of a party, a duly authorized committee thereof, or a duly authorized officer of such A-34 party. The failure of any party at any time or times to require performance of any provision of this Plan of Merger shall in no manner affect such party's right at a later time to enforce the same provision. No waiver by any party of any condition, or of the breach of any term, covenant, representation, or warranty contained in this Plan of Merger, whether by conduct or otherwise, in any one or more instances shall be deemed to be or construed as a further or continuing waiver of any such condition or breach, or as a waiver of any other condition or of the breach of any other term, covenant, representation, or warranty. 10.9 Notices. All notices, requests, demands, and other communications under this Plan of Merger shall be in writing and shall be deemed to have been duly given and effective immediately if delivered or sent and received by a fax transmission (if receipt by the intended recipient is confirmed by telephone and if hard copy is delivered by overnight delivery service the next day), a hand delivery, or a nationwide overnight delivery service (all fees prepaid) to the following addresses: If to Grand: With a copy to: Grand Bank Financial Corporation Warner Norcross & Judd LLP Attention: Charles C. Stoddard, CEO Attention: Gordon R. Lewis 126 Ottawa Avenue, NW, Suite 100 900 Fifth Third Center P.O. Box 3580 111 Lyon Street, NW Grand Rapids, Michigan 49503-2867 Grand Rapids, Michigan 49503-2487 Telephone: 616-235-7000 Telephone: 616-752-2000 Fax: 616-235-2160 Fax: 616-222-2752 If to Macatawa: With a copy to: Macatawa Bank Corporation Varnum, Riddering Schmidt & Howlett LLP Attention: Benj. A. Smith, III, Attention: Donald L. Johnson Chairman and CEO Bridgewater Place c/o Smith & Associates P.O. Box 352 106 East 8th Street 333 Bridge Street, NW Holland, Michigan 49423 Grand Rapids, Michigan 49501-0352 Telephone: 616-396-0199 (49504 for deliveries) Fax: 616-396-2381 Telephone: 616-336-6000 Fax: 616-336-7000 10.10 Governing Law. This Plan of Merger shall be governed, construed, and enforced in accordance with the laws of the State of Michigan, without regard to principles of conflicts of laws. 10.11 Entire Agreement. This Plan of Merger (including all exhibits and ancillary agreements described in this Plan of Merger) supersedes all prior agreements between the parties with respect to its subject matter and constitutes (along with the agreements and documents referred to in this Plan of Merger) a complete and exclusive statement of the terms of the agreement between the parties with respect to its subject matter; except for matters set forth in any written instrument concurrently or contemporaneously executed by the parties. No party may assign any of its rights or obligations under this Plan of Merger to any other person. 10.12 Third Party Beneficiaries. The terms and conditions of this Plan of Merger shall inure to the benefit of and be binding upon Macatawa and Grand and their respective successors. Except to the extent provided in Sections 5.11 (Indemnification) and 5.12 (Insurance), nothing in this Plan of Merger, express or implied, is intended to confer upon any person other than Macatawa and Grand any rights, remedies, obligations, or liabilities under or by reason of this Plan of Merger. 10.13 Counterparts. This Plan of Merger may be executed in one or more counterparts, which taken together shall constitute one and the same instrument. Executed counterparts of this Plan of Merger shall be deemed to have been fully delivered and shall become legally binding if and when executed signature pages are received by facsimile transmission from a party. If so delivered by facsimile transmission, the parties agree

to promptly send original, manually executed copies by nationwide overnight delivery service. 10.14 Further Assurances; Privileges. Macatawa and Grand each shall, at the request of the other, execute and deliver such additional documents and instruments and take such other actions as may be reasonably requested to carry out the terms and provisions of this Plan of Merger. A-35 10.15 Headings, Etc. The article headings and section headings contained in this Plan of Merger are inserted for convenience only and shall not affect in any way the meaning or interpretation of this Plan of Merger. With respect to any term, references to the singular form of the word include its plural form and references to the plural form of the word include its singular form. 10.16 Calculation of Dates and Deadlines. Unless otherwise specified, any period of time to be determined under this Plan of Merger shall be deemed to commence at 12:01 a.m. on the first full day after the specified starting date, event, or occurrence. Any deadline, due date, expiration date, or period-end to be calculated under this Plan of Merger shall be deemed to end at 5 p.m. on the last day of the specified period. The time of day shall be determined with reference to the then current local time in Holland, Michigan. 10.17 Severability. If any term, provision, covenant, or restriction contained in this Plan of Merger is held by a final and unappealable order of a court of competent jurisdiction to be invalid, void, or unenforceable, then the remainder of the terms, provisions, covenants, and restrictions contained in this Plan of Merger shall remain in full force and effect, and shall in no way be affected, impaired, or invalidated unless the effect would be to cause this Plan of Merger to not achieve its essential purposes. The undersigned have duly executed and acknowledged this Plan of Merger as of the date first written above. GRAND BANK FINANCIAL CORPORATION By: /s/ Charles C. Stoddard Charles C. Stoddard Its Chairman and CEO MACATAWA BANK CORPORATION By: /s/ Benj. A. Smith III Benj. A. Smith III Its Chairman and CEO A-36 Appendix B November 20, 2001 CONFIDENTIAL Board of Directors Grand Bank Financial Corporation 126 Ottawa Avenue NW, Ste 100 Grand Rapids, Michigan 49503 Members of the Board: You have requested our opinion as to the fairness, from a financial point of view, to Grand Bank Financial Corporation, Grand Rapids, Michigan ("Grand") and its shareholders, of the terms of the Agreement and Plan of Merger dated as of November 20, 2001 (the "Agreement") between Grand and Macatawa Bank Corporation, Holland, Michigan ("Macatawa"). The Agreement provides for the Merger of Grand with and into Macatawa (the "Merger"), with Macatawa being the surviving company. The terms of the Agreement provide for a fixed exchange ratio in which each common share of Grand will be exchanged for 17.5979 shares of Macatawa common stock. Based on Grand's current common shares outstanding, Macatawa will issue approximately 2,375,000 shares of common stock to Grand common stockholders. The Agreement further provides that stock options previously granted by Grand be converted into and become options to purchase Macatawa common stock. Austin Associates, LLC ("Austin Associates"), as part of its investment banking practice, is customarily engaged in the valuation of businesses and securities in connection with mergers and acquisitions, and valuations for estate, corporate and other purposes. Austin Associates acted as Grand's financial advisor in connection with, and has participated in negotiations leading to, the Agreement. In connection with rendering our opinion set forth herein, we have among other things: (i) Reviewed the audited financial statements of Grand for each of the years ending 1996 through 2000, and the audited financial statements of Macatawa for each of the years ending 1998-2000; (ii) Reviewed unaudited financial statements of Grand and Macatawa for the quarters ended March 31, 2001, June 30, 2001 and September 30, 2001; (iii) Reviewed certain other internal information, primarily financial in nature, relating to the respective businesses, earnings, assets and prospects of Grand and Macatawa provided to us or publicly available for purposes of our analysis; (iv) Participated in meetings and telephone conferences with representatives of Grand and Macatawa concerning the financial condition, business, assets, financial forecasts and prospects of the companies, as well as other matters we believed relevant to our inquiry; (v) Compared the results of operations and financial condition of Grand with that of certain companies, which we deemed to be relevant for purposes of this opinion; (vi) Reviewed the financial terms, to the extent publicly available, of certain acquisition transactions, which we deemed to be relevant for purposes of this opinion; (vii) Reviewed the Agreement and certain related documents; and (viii) Performed such other reviews and analyses as we have deemed appropriate. B-1 In our review and analysis, we relied upon and assumed the accuracy and completeness of the financial and other information provided to us or publicly available, and have not attempted to verify the same. We have made no independent verification as to the status and value of Grand or Macatawa's assets, and have instead relied upon representations and information concerning assets of both companies in the aggregate. In rendering our opinion, we have assumed that the transaction will be a tax-free reorganization with no material adverse tax consequences to Grand or Macatawa, or to Grand shareholders receiving Macatawa stock. In addition, we have assumed in the course of obtaining the necessary approvals for the transaction,

no condition will be imposed that will have a material adverse effect on the contemplated benefits of the transaction to Grand and its shareholders. This opinion is based on economic and market conditions and other circumstances existing on, and information made available as of, the date hereof. This opinion is limited to the fairness, from a financial point of view, of the terms of the Agreement, and does not address the underlying business decision by Grand's Board of Directors to effect the Merger and does not constitute a recommendation to any Grand shareholder as to how such shareholder should vote with respect to the Merger. Austin Associates reserves the right to review all disclosures in the proxy materials and consent to the characterization of our fairness opinion. For our services in rendering this opinion, Grand will pay us a fee, a significant portion of which is contingent upon the consummation of the Merger. Grand has also agreed to indemnify us against certain liabilities. Based upon our analysis and subject to the qualifications described herein, we believe that as of the date of this letter, the terms of the Agreement are fair, from a financial point of view, to Grand and its shareholders. Respectfully, /s/ Austin Associates, LLC Austin Associates, LLC B-2 Appendix C [To be filed by Amendment] C-1 PART II. INFORMATION NOT REQUIRED IN PROSPECTUS Item 20. Indemnification of Directors and Officers. Macatawa Bank Corporation ("Macatawa") is obligated under its Restated Articles of Incorporation to indemnify its directors and executive officers who serve or have served at the request of Macatawa as directors, officers, employees, agents or fiduciaries of Macatawa or another corporation or other enterprise to the fullest extent permitted under the Michigan Business Corporation Act. Persons who are not directors or executive officers may be similarly indemnified in respect of such services to the extent authorized by Macatawa's Board of Directors. Sections 561 through 571 of the Michigan Business Corporation Act contain provisions governing the indemnification of directors and officers by Michigan corporations. That statute provides that a corporation has the power to indemnify a person who was or is a party or is threatened to be made a party to a threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative and whether formal or informal (other than an action by or in the right of the corporation) by reason of the fact that he or she is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, partner, trustee, employee or agent of another foreign or domestic corporation, partnership, joint venture, trust or other enterprise, whether for profit or not, against expenses (including attorneys' fees), judgments, penalties, fines and amounts paid in settlement actually and reasonably incurred by him or her in connection with the action, suit or proceeding, if the person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the corporation or its shareholders, and with respect to a criminal action or proceeding, if the person had no reasonable cause to believe his or her conduct was unlawful. The termination of an action, suit or proceeding by judgment, order, settlement or conviction, or upon a plea of nolo contendere or its equivalent, does not, of itself, create a presumption that the person did not act in good faith and in a manner that he or she reasonably believed to be in or not opposed to the best interests of the corporation or its shareholders, and, with respect to a criminal action or proceeding, had reasonable cause to believe that his or her conduct was unlawful. Indemnification of expenses (including attorneys' fees) and amounts paid in settlement is permitted in derivative actions, except that indemnification is not allowed for any claim, issue or matter in which such person has been found liable to the corporation unless and to the extent that a court decides indemnification is proper. To the extent that any director or officer has been successful on the merits or otherwise in defense of an action, suit or proceeding, or in defense of a claim, issue or matter in the action, suit or proceeding, he or she shall be indemnified against actual and reasonable expenses (including attorneys' fees) incurred by him or her in connection with the action, suit or proceeding, and any action, suit or proceeding brought to enforce the mandatory indemnification provided under the Michigan Business Corporation Act. The Michigan Business Corporation Act permits partial indemnification for a portion of expenses (including reasonable attorneys' fees), judgments, penalties, fines and amounts paid in settlement to the extent the person is entitled to indemnification for less than the total amount. A determination that the person to be indemnified meets the applicable standard of conduct and an evaluation of the reasonableness of the expenses incurred and amounts paid in settlement shall be made by a majority vote of a quorum of the Board of Directors who are not parties or threatened to be made parties to the action, suit or proceeding, by a majority vote of a committee of not less than two disinterested directors, by independent legal counsel, by all "independent directors" not parties or threatened to be made parties to the action, suit or proceeding, or by the shareholders. An authorization for payment of indemnification may be made by: (1) the Board of Directors by (a) a majority vote of two or more directors who are not parties or threatened to be made parties to the action, suit or proceeding, (b) a majority vote of a committee of two or more directors who are not parties or threatened to be made

parties to the action, suit or proceeding, (c) a majority vote of one or more "independent directors" who are not parties or threatened to be made parties to the action, suit or proceeding, or (d) if the corporation lacks the appropriate persons for alternatives (a) through (c), by a majority vote of the entire Board of Directors; or (2) the shareholders. Under the Michigan Business Corporation Act, Macatawa may indemnify a director without a determination that the director has met the applicable standard of conduct unless the director received a financial benefit to which he or she was not entitled, intentionally inflicted harm on the corporation or its shareholders, violated Section 551 of the Michigan Business Corporation Act (which prohibits certain dividends, distributions to shareholders and certain loans to insiders of the corporation), or intentionally committed a criminal act. A director may file for a court determination of the propriety of indemnification in any of the situations set forth in the preceding sentence. Under the Michigan Business Corporation Act, Macatawa may pay or reimburse the reasonable expenses incurred by a director, officer, employee or agent who is a party or threatened to be made a party to an action, suit or proceeding in advance of final disposition of the proceeding if the person furnishes the corporation a written undertaking to repay the Part II-1 advance if it is ultimately determined that he or she did not meet the standard of conduct, which undertaking need not be secured. The indemnification provisions of the Michigan Business Corporation Act are not exclusive of the rights to indemnification under a corporation's articles of incorporation or bylaws or by agreement. However, the total amount of expenses advanced or indemnified from all sources combined may not exceed the amount of actual expenses incurred by the person seeking indemnification or advancement of expenses. The indemnification provided for under the Michigan Business Corporation Act continues as to a person who ceases to be a director, officer, employee or agent. The Michigan Business Corporation Act permits Macatawa to purchase insurance on behalf of its directors, officers, employees and agents against liabilities arising out of their positions with Macatawa, whether or not such liabilities would be within the above indemnification provisions. Pursuant to this authority, Macatawa maintains such insurance on behalf of its directors, officers, employees and agents. Part II-2 Item 21. Exhibits and Financial Statement Schedules. A. Exhibits. The following exhibits are filed as part of this Registration Statement: Number Exhibit 2 Agreement and Plan of Merger dated November 20, 2001. Included as Appendix A to the prospectus and joint proxy statement. 4.1 Articles of Incorporation of Macatawa Bank Corporation, incorporated by reference to Exhibit 3.1 to the Macatawa Bank Corporation Registration Statement on Form SB-2 (Registration No. 333-45755). 4.2 Bylaws of Macatawa Bank Corporation, incorporated by reference to Exhibit 3.2 to the Macatawa Bank Corporation Registration Statement on Form SB-2 (Registration No. 333-45755). 5.1 Opinion of Varnum, Riddering, Schmidt & Howlett LLP. 8.1 Opinion of Varnum, Riddering, Schmidt & Howlett LLP as to Tax Matters.* 23.1 Consent of Macatawa's Independent Accountants, Crowe, Chizek and Company LLP. 23.2 Consent of Grand's Independent Certified Public Accountants, BDO Seidman LLP. 23.3 Consent of Macatawa's Counsel. Included in Exhibit 5.1 23.4 Consent of Grand's Counsel. 23.5 Consent of Grand's Financial Advisor. 23.6 Consent of Macatawa's Financial Advisor. * 24 Powers of Attorney (included on the signature page on page II-6 of this Registration Statement on Form S-4). 99.1 Notice of Special Meeting of Macatawa Shareholders. 99.2 Form of Proxy for Macatawa Bank Corporation. 99.3 Notice of Special Meeting of Grand Shareholders. 99.4 Form of Proxy for Grand Bank Financial Corporation. * To be filed by Amendment. B. Financial Statements and Schedules. All schedules for which provision is made in Regulation S-X of the Securities and Exchange Commission have been omitted because they either are not required under the related instructions or the required information has been included in the financial statements of Macatawa or notes thereto. C. Opinions of Financial Advisor. The form of opinion of Austin Associates, LLC is included as Appendix B to the prospectus and joint proxy statement. The opinion of Donnelly, Penman, French, Haggarty & Co. will be included as Appendix C to the prospectus and joint proxy statement upon filing of an Amendment. Part II-3 Item 22. Undertakings. The undersigned registrant hereby undertakes: (1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement: (i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933; (ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low end or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20 percent change in the maximum aggregate offering price set forth in the "Calculation of Registration

Fee" table in the effective registration statement; (iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement;" (2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. (3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering. The undersigned registrant hereby undertakes that, for purposes of determining any liability under the Securities Act of 1933, each filing of the registrant's annual report pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. The undersigned registrant hereby undertakes as follows: that prior to any public reoffering of the securities registered hereunder through use of a prospectus which is a part of this registration statement, by any person or party who is deemed to be an underwriter within the meaning of Rule 145(c), the issuer undertakes that such reoffering prospectus will contain the information called for by the applicable registration form with respect to reofferings by persons who may be deemed underwriters, in addition to the information called for by the other items of the applicable form. The undersigned registrant undertakes that every prospectus: (i) that is filed pursuant to the paragraph immediately preceding, or (ii) that purports to meet the requirements of Section 10(a)(3) of the Securities Act of 1933 and is used in connection with an offering of securities subject to Rule 415, shall be filed as a part of an amendment to the registration statement and will not be used until such amendment is effective, and that, for purposes of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act of 1933 and will be governed by the final adjudication of such issue. Part II-4 The undersigned registrant hereby undertakes to respond to requests for information that is incorporated by reference into the prospectus pursuant to Item 4, 10(b), 11, or 13 of this form, within one business day of receipt of such request, and to send the incorporated documents by first class mail or other equally prompt means. This includes information contained in documents filed subsequent to the effective date of the registration statement through the date of responding to the request. The undersigned registrant hereby undertakes to supply by means of a post-effective amendment all information concerning a transaction, and the company being acquired involved therein, that was not the subject of and included in the registration statement when it became effective. * * * * Part II-5 SIGNATURES Pursuant to the requirements of the Securities Act of 1933, the Registrant has duly caused this Registration Statement to be signed on its behalf by the undersigned thereunto duly authorized, in the City of Holland, State of Michigan, on December 28, 2001. MACATAWA BANK CORPORATION By: /s/ Benjamin A. Smith, III Benjamin A. Smith, III Chief Executive Officer KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Benj. A. Smith, III and Philip J. Koning, and each of them, his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this Registration Statement, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in a and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or his substitute may lawfully do or cause to be done by virtue hereof. Pursuant

to the requirements of the Securities Act of 1933, this Registration Statement has been signed by the following persons in the capacities and on the dates indicated Signature Title Date ----- /s/ Benj. A. Smith, III Benj. A. Smith, III Principal Executive Officer December 28, 2001 and a Director /s/ Steven L. Germond Steven L. Germond Principal Financial and December 28, 2001 Accounting Officer /s/ Philip J. Koning Philip J. Koning President and a Director December 28, 2001 /s/ G. Thomas Boylan G. Thomas Boylan Director December 28, 2001 /s/ Robert E. DenHerder Robert E. DenHerder Director December 28, 2001 /s/ John F. Koetje John F. Koetje Director December 28, 2001 Part II-6 EXHIBIT INDEX Number Exhibit 2 Agreement and Plan of Merger dated November 20, 2001. 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Included in Exhibit 5.1 23.4 Consent of Grand's Counsel. 23.5 Consent of Grand's Financial Advisor. 23.6 Consent of Macatawa's Financial Advisor. * 24 Powers of Attorney (included on the signature page on page II-6 of this Registration Statement on Form S-4). 99.1 Notice of Special Meeting of Macatawa Shareholders. 99.2 Form of Proxy for Macatawa Bank Corporation. 99.3 Notice of Special Meeting of Grand Shareholders. 99.4 Form of Proxy for Grand Bank Financial Corporation. * To be filed by Amendment Part II-7 Exhibit 5.1 December 28, 2001 Macatawa Bank Corporation 348 South Waverly Road Holland, Michigan 49423 Subject: Registration Statement on Form S-4 2,459,905 Shares of Common Stock, No Par Value per Share Gentlemen: We are counsel to Macatawa Bank Corporation ("Macatawa") in connection with the registration under the Securities Act of 1933, as amended (the "Securities Act"), of shares of Macatawa common stock, no par value ("Common Stock"), pursuant to a registration statement on Form S-4 (the "Registration Statement") filed with the Securities and Exchange Commission (the "Commission") on or about December 28, 2001. We are familiar with the proceedings taken by Macatawa in connection with the authorization of up to 2,459,905 shares of Common Stock to be issued to the shareholders of Grand Bank Financial Corporation. We have examined such documents, records, and matters of law as we have deemed necessary for purposes of this opinion. In our examination, we have assumed the genuineness of all signatures, the legal capacity of all natural persons, the authenticity of all documents submitted to us as originals, the conformity to original documents of all documents submitted to us as certified or photostatic copies, and the authenticity of the originals of such copies. Based upon the foregoing, we are of the opinion that the Common Stock will be, when duly registered under the Securities Act and issued and delivered as described in the Registration Statement, legally issued, fully paid, and nonassessable. We consent to the filing of this opinion as an exhibit to the Registration Statement and to the references to our firm in the Registration Statement. This opinion is rendered for the purposes of Item 21 of Form S-4 and Item 601 of Regulation S-K, may be relied upon only by you and the Commission and may not be used, quoted, or referred to or filed for any other purpose without our prior written permission. Very truly yours, VARNUM, RIDDERING, SCHMIDT & HOWLETT LLP /s/ Varnum, Riddering, Schmidt & Howlett LLP DLJ/mjb Exhibit 5.1-1 Exhibit 23.1 Consent of Independent Accountants We hereby consent to the incorporation by reference in the Registration Statement of Macatawa Bank Corporation on Form S-4 and related Prospectus/Joint Proxy Statement of our report dated January 24, 2001, on the consolidated financial statements of Macatawa Bank Corporation, as of December 31, 2000 and 1999, and for each of the three years in the period ended December 31, 2000 appearing in the 2000 Form 10-K of Macatawa Bank Corporation. We also consent to the use of our name as "Experts" in the Prospectus/Joint Proxy Statement. /s/ Crowe, Chizek and Company LLP Crowe, Chizek and Company LLP December 26, 2001 Grand Rapids, Michigan Exhibit 23.1-1 Exhibit 23.2 CONSENT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS We do hereby consent to the use in this Registration Statement (Form S-4) of Macatawa Bank Corporation and related Prospectus/Joint Proxy Statement of our report dated January 17, 2001 on the consolidated balance sheets of Grand Bank Financial Corporation as of December 31, 2000 and 1999, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2000, contained therein. We also consent to the reference to us under the caption "Experts" in the Prospectus/Joint Proxy Statement. /s/ BDO SEIDMAN, LLP Grand Rapids, Michigan December 28, 2001 Exhibit 23.2-1 Exhibit 23.5 Consent of Austin Associates, LLC We

hereby consent to the use of our opinion letter to the Board of Directors of Grand Bank Financial Corporation, included as Appendix B to the Proxy Statement/Prospectus which forms part of the Registration Statement dated as of the date hereof on Form S-4 relating to the proposed Merger of Grand Bank Financial Corporation and Macatawa Bank Corporation and to the references to such opinion therein. In giving such consent, we do not admit that we come within the category of persons whose consent is required under Section 7 of the Securities Act 1933, as amended, or the rules and regulations of the Securities and Exchange Commission thereunder, nor do we hereby admit that we are experts with respect to any part of such Registration Statement within the meaning of the term experts as used in the Securities Act of 1933, as amended, or the rules and regulations of the Securities and Exchange Commission thereunder. Austin Associates, LLC By: /s/ Austin Associates, LLC December 28, 2001 Grand Rapids, Michigan Exhibit 23.5-1 Exhibit 99.1 [MACATAWA LOGO] MACATAWA BANK CORPORATION 348 Waverly Road Holland, Michigan 49423 Telephone (616) 820-1444 Dear Shareholder: On behalf of Macatawa Bank Corporation's Board of Directors, I cordially invite you to attend the Special Meeting of Shareholders of Macatawa Bank Corporation to be held on: _____, _____, 2002 _____ local time

_____ Holland, Michigan 49423 for the following purposes: 1. The approval and adoption of the Agreement and Plan of Merger, dated as of November 20, 2001, between Macatawa Bank Corporation and Grand Bank Financial Corporation and the issuance of shares of Macatawa Bank Corporation's common stock pursuant to the Agreement and Plan of Merger, pursuant to which Grand will merge into Macatawa and each share of Grand common stock will be converted into 17.5979 shares of Macatawa common stock (and cash in lieu of fractional shares); and 2. To transact such other business as may properly come before the special meeting or any adjournment or postponements thereof. The terms of the Merger Agreement, as well as other important information relating to Macatawa and Grand, are contained in the attached prospectus and joint proxy statement. Please give this document your careful attention. Macatawa's Board of Directors has approved the Merger Agreement and unanimously recommends that Macatawa's shareholders vote "FOR" its approval and adoption and the approval of the issuance of shares of Macatawa Bank Corporation's common stock pursuant to the Merger Agreement. Only holders of Macatawa common stock as of the close of business on _____, 2002 are entitled to vote at the special meeting. This notice and the attached prospectus and joint proxy statement and the accompanying form of proxy are being mailed on or about _____, 2002. Because of the significance of the issuance of stock and proposed Merger to Macatawa, your vote at the special meeting, either in person or by proxy, is especially important. Whether or not you plan to attend the special meeting, please complete, sign and date the enclosed proxy card and return it in the enclosed postage-paid envelope. You may revoke your proxy at any time before the special meeting, as more fully explained in the attached prospectus and joint proxy statement. Thank you for your prompt attention to this important matter. By Order of the Board of Directors Philip J. Koning, Secretary Holland, Michigan Exhibit 99.1-1 Exhibit 99.2 REVOCABLE PROXY MACATAWA BANK CORPORATION Special Meeting of Shareholders THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS The undersigned hereby appoints Benj. A. Smith, III and Philip J. Koning, or either of them, of Macatawa Bank Corporation ("Macatawa"), with full power of substitution, to act as attorneys and proxies for the undersigned to vote all shares of common stock of Macatawa that the undersigned is entitled to vote at Macatawa's Special Meeting of Shareholders (the "Meeting"), to be held on _____, 2002, at _____, located at _____, Holland, Michigan 49423, at _____ local time, and any and all adjournments and postponements thereof. This proxy may be revoked at any time before it is voted by: (i) filing with the Secretary of Macatawa at or before the Meeting a written notice of revocation bearing a later date than this proxy; (ii) duly executing a subsequent proxy relating to the same shares and delivering it to the Secretary of Macatawa at or before the Meeting; or (iii) attending the Meeting and voting in person (although attendance at the Meeting will not in and of itself constitute revocation of this proxy). If this proxy is properly revoked as described above, then the power of such attorneys and proxies shall be considered terminated and of no further force and effect. The undersigned acknowledges receipt from Macatawa, prior to the execution of this proxy, of Notice of the Special Meeting and a Prospectus and Joint Proxy Statement. (Continued and to be signed on reverse side) Exhibit 99.2-1 MACATAWA BANK CORPORATION PLEASE MARK VOTE IN OVAL IN THE FOLLOWING MANNER USING DARK INK ONLY. (X) The approval and adoption of the Agreement and Plan of Merger, dated as of November 20, 2001 (the "Merger Agreement"), between Macatawa Bank Corporation and Grand Bank Financial Corporation and the issuance of shares of Macatawa Bank Corporation common stock pursuant to the Merger Agreement. For Against Abstain () () () The Board of Directors recommends

a vote "FOR" approval of the Merger Agreement. THIS PROXY WILL BE VOTED AS DIRECTED, BUT IF NO DIRECTIONS ARE SPECIFIED, THIS PROXY WILL BE VOTED FOR APPROVAL OF THE MERGER AGREEMENT AND THE ISSUANCE OF SHARES OF MACATAWA BANK CORPORATION PURSUANT TO THE MERGER AGREEMENT. IF ANY OTHER BUSINESS IS PRESENTED AT THE MEETING, THIS PROXY WILL BE VOTED BY THOSE NAMED IN THIS PROXY IN THEIR JUDGMENT. AT THE PRESENT TIME, THE BOARD OF DIRECTORS KNOWS OF NO OTHER BUSINESS TO BE PRESENTED AT THE MEETING.

Dated: _____, 2002 Print Name: _____ Signature: _____ Print Name: _____ Signature: _____ Please sign exactly as your name appears on

this card. When signing as attorney, executor, administrator, trustee or guardian, please give your full title. If shares are held jointly, each holder should sign. PLEASE PROMPTLY COMPLETE, SIGN AND MAIL THIS PROXY IN THE ENCLOSED POSTAGE-PAID ENVELOPE Exhibit 99.2-2 Exhibit 99.3 [GRAND BANK FINANCIAL CORPORATION LOGO] GRAND BANK FINANCIAL CORPORATION 126 Ottawa Avenue, N.W., Ste. 100 Grand Rapids, Michigan 49503-2867 Telephone: (616) 235-7000 Dear Shareholder: On behalf of Grand Bank Financial Corporation's Board of Directors we cordially invite you to attend a special meeting of shareholders of Grand Bank Financial Corporation to be held on: [TIME, DATE, AND LOCATION TO BE COMPLETED] for the purpose of considering and acting upon approval of an Agreement and Plan of Merger, dated as of November 20, 2001, between Macatawa Bank Corporation and Grand Bank Financial Corporation, pursuant to which Grand will merge into Macatawa and each share of Grand common stock will be converted into 17.5979 shares of Macatawa common stock (and cash in lieu of fractional shares); and such other matters as may properly come before the special meeting or any adjournments or postponements thereof. The terms of the Merger Agreement, as well as other important information relating to Macatawa and Grand, are contained in the attached prospectus and joint proxy statement. Please give this document your careful attention. Grand's Board of Directors has adopted the Merger Agreement and recommends that Grand's shareholders vote "FOR" its approval. Only holders of Grand common stock as of the close of business on December ____, 2001 are entitled to vote at the special meeting. This notice and the attached prospectus and joint proxy statement and the accompanying form of proxy are being mailed on or about _____, 2002. Because of the significance of the proposed Merger to Grand, your vote at the special meeting, either in person or by proxy, is especially important. Whether or not you plan to attend the special meeting, please complete, sign and date the enclosed proxy card and return it promptly in the enclosed postage-paid envelope. Thank you for your prompt attention to this important matter. Sincerely, Charles C. Stoddard Thomas J. Wesholski Chairman of the Board and Chief President and Chief Operating Officer Executive Officer Grand Rapids, Michigan Exhibit 99.3-1 Exhibit 99.4 REVOCABLE PROXY GRAND BANK FINANCIAL CORPORATION Special Meeting of Shareholders THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS The undersigned hereby appoints Charles C. Stoddard, Thomas J. Wesholski and Robert W. DeJonge or any of them, with full power of substitution, to act as attorneys and proxies for the undersigned to vote all shares of common stock of Grand Bank Financial Corporation ("Grand") that the undersigned is entitled to vote at Grand's Special Meeting of Shareholders (the "Meeting"), to be held on _____, 2002, at _____, located at _____, at _____ a.m., local time, and any and all adjournments and postponements thereof..

The undersigned acknowledges receipt from Grand prior to the execution of this proxy, of Notice of the Special Meeting and a Prospectus and Joint Proxy Statement. (Continued and to be signed on reverse side) Exhibit 99.4-1 GRAND BANK FINANCIAL CORPORATION PLEASE MARK VOTE IN OVAL IN THE FOLLOWING MANNER USING DARK INK ONLY. (X) Approval of the Agreement and Plan of Merger, dated as of November 20, 2001 (the "Merger Agreement"), between Macatawa Bank Corporation and Grand Bank Financial Corporation. For Against Abstain () () () The Board of Directors recommends a vote "FOR" approval of the Agreement and Plan of Merger. This proxy will be voted as directed. If no directions are specified, this proxy will be voted for approval of the Merger Agreement. If any other business is presented at the meeting, this proxy will be voted by those named in this proxy in their judgment. At the present time, the Board of Directors knows of no other business to be presented at the meeting. Dated: _____, 2002 Print Name: _____

Signature: _____ Print Name: _____

Signature: _____ Please sign exactly as your name appears on this card. When signing as attorney, executor, administrator, trustee or guardian, please give your full title. If shares are held jointly, each holder should sign. YOUR VOTE IS IMPORTANT! PLEASE PROMPTLY COMPLETE, SIGN AND MAIL THIS

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PROXY IN THE ENCLOSED POSTAGE-PAID ENVELOPE