

FIRST QUARTER REPORT

***13 Weeks Ended
January 24, 2010***



ARBOR MEMORIAL SERVICES INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis for Arbor Memorial Services Inc. ("Arbor" or the "Company") has been prepared for the 13 weeks ended January 24, 2010 and includes material information available up to March 4, 2010. The financial data provided has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and all figures provided are in Canadian dollars. Management's Discussion and Analysis herewith provided is the responsibility of the Company's management. The Board of Directors is responsible for reviewing and approving Management's Discussion and Analysis. Additional information relating to Arbor, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com.

Information Regarding Forward-Looking Statements

Certain statements contained in this Management's Discussion and Analysis including, but not limited to, information regarding the status and progress of the Company's operating and capital activities, the plans and objectives of the Company and assumptions regarding the Company's future performance are forward-looking statements. Forward-looking statements may include words such as "believes", "may", "should", "estimates", "continues", "indicates", "suggests", "anticipates", "intends", "plans", "expects" and similar expressions. These forward-looking statements are based on current expectations and various factors and assumptions. Accordingly, these forward-looking statements are subject to certain risks and uncertainties. The material factors and assumptions that were applied in making the forward-looking statements in this Management's Discussion and Analysis include, but are not limited to: reliance on third party reports from government bodies and industry associations, the use of economic forecasts prepared by various financial institutions, historical experience, and financial reporting of competitors and suppliers. Risks and uncertainties that could cause or contribute to actual results differing from such statements include, but are not limited to, those discussed elsewhere in this Management's Discussion and Analysis, particularly under "Events and Uncertainties", and in the Company's 2009 Annual Information Form under "Description of the Business – Risk Factors" and 2009 Annual Report under "Risks, Events and Uncertainties". The Company cannot provide any assurance that forward-looking statements will materialize. The Company assumes no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, except in accordance with applicable securities laws.

Non-GAAP Financial Measures

In addition to the GAAP results provided in this Management's Discussion and Analysis, some of the discussion of operating performance is based on earnings before interest expense and income taxes ("EBIT"). EBIT excludes the impact of interest expense and income taxes as disclosed in the statements of earnings. EBIT is a non-GAAP financial measure that does not have any standardized meaning prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by other companies. This non-GAAP financial measure is provided as a supplement, and should not be considered an alternative to measurements required by GAAP. Management uses EBIT to assess its operating results, as it believes it is important to assess the cemetery, funeral, and corporate activities without these non-operating components. Management believes that this measure provides useful additional information to management and investors regarding the Company's performance as it provides a basis for analyzing the ongoing operating results, which may vary due to different market and economic factors than those that affect interest expense and income taxes. For a quantitative reconciliation from EBIT to net earnings from continuing operations, refer to the Unaudited Consolidated Statements of Earnings in the Financial Statements included in this First Quarter Report.

Future Accounting Policy Changes

International Financial Reporting Standards

The Canadian Accounting Standards Board ("AcSB") confirmed in 2008 that for fiscal years commencing on or after January 1, 2011, all publicly accountable enterprises are required to report their financial results using International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). IFRS uses a conceptual framework similar to Canadian Generally Accepted Accounting Principles, but there are some differences in recognition, measurement and disclosures. The Company is required to prepare its first financial statements that are compliant with IFRS for the interim period ended January 2012 with comparative figures for the prior period. The Company continues to develop a plan to convert its consolidated financial statements to IFRS, and is currently assessing the differences between IFRS and its current accounting policies, as well as the alternatives available upon adoption. The effect of adopting IFRS has not yet been quantified. The majority of the project work is scheduled for fiscal 2010. However, the project will be an ongoing process as the IASB and the AcSB issue new standards and recommendations.

RESULTS OF OPERATIONS

The data set forth herein should be read in conjunction with the Company's consolidated financial statements and accompanying notes included in the Company's 2009 Annual Report. Historical information provided is not necessarily indicative of the results to be expected in the future.

RESULTS OF OPERATIONS FOR THE 13 WEEKS ENDED JANUARY 24, 2010 COMPARED TO THE 13 WEEKS ENDED JANUARY 25, 2009

TOTAL COMPANY RESULTS

Revenue for the 13 weeks ended January 24, 2010 was \$64.1 million compared to \$58.3 million for the 13 weeks ended January 25, 2009. This represented an increase of \$5.7 million or 9.8%. Following is a breakdown of total revenue:

	2010		2009	
	\$Millions	% of Total	\$Millions	% of Total
Sales				
Cemetery	27.8	43.4	23.3	39.9
Funeral	31.6	49.3	31.0	53.2
	<u>59.4</u>	<u>92.7</u>	<u>54.3</u>	<u>93.1</u>
Investment and other income	4.7	7.3	4.0	6.9
	<u>64.1</u>	<u>100.0</u>	<u>58.3</u>	<u>100.0</u>

Sales increased by \$5.1 million or 9.3% in 2010 compared to 2009. Sales in the cemetery division increased by \$4.5 million or 19.1% due primarily to higher sales of pre-need burial spaces and delivery of markers. Sales in the funeral division increased by \$0.6 million or 2.0%.

Investment and other income increased by \$0.7 million or 16.8% over 2009 due primarily to higher annuity fee income in the funeral division.

Operating expenses increased by \$4.5 million or 9.7% over 2009 due primarily to an increase in the cost of sales of \$2.4 million or 19.3% and obtaining costs of \$1.3 million or 22.8%. The increase in cost of sales was mainly in the cemetery division and was due to higher sales and mix of products sold. The increase in obtaining costs was related to a 31.1% increase in pre-need contracts written. Excluding cost of sales and obtaining costs, operating expenses increased by \$0.9 million or 3.0%.

Corporate expenses increased by \$0.2 million or 6.0% from 2009, which was primarily attributable to a non-recurring provincial sales tax expense of \$0.1 million that resulted from a provincial sales tax review in the first quarter of 2010 and a \$0.1 million increase in employee salaries and wages.

Earnings before interest expense and income taxes ("EBIT") increased by \$1.0 million or 12.9% over 2009 to \$8.6 million. The increase in EBIT was the result of an increase of \$1.4 million in the cemetery division due to higher sales. The favourable variance in the cemetery division was partially offset by an increase in the loss of the corporate division of \$0.3 million or 7.5% and lower earnings of the funeral division of \$0.1 million or 0.9%.

Interest expense included interest on floating-rate bank term debt and the cost of the Company's interest rate swap contracts. Interest expense decreased by \$0.2 million or 32.5% to \$0.4 million in 2010 due to a decrease in the weighted average balance of long-term debt outstanding of \$3.7 million or 7.7% and a lower average floating rate of interest of 3.4% compared to 4.7% in 2009, the impact of which was partially offset by higher swap costs of \$0.1 million. The weighted average long-term debt balance decreased due to repayments on the bank term loans in the fourth quarter of 2009. The proportion of fixed rate debt to total debt at January 24, 2010 and October 25, 2009 was 44% compared to 61% at January 25, 2009.

Income taxes for the first quarter of 2010 reflected an effective tax rate of 35.4% compared to 32.8% in the first quarter of 2009. The increase in the effective rate of 2.6 percentage points was primarily due to the unfavourable impact of future tax changes of \$0.4 million or 4.1 percentage points, which occurred mainly due to a decrease in federal and provincial substantively enacted rates applied to the Company's net future tax assets. The unfavourable impact of future tax changes was partially offset by a lower combined basic rate of 1.0 percentage point and the favourable impact of dividends of 0.5 of a percentage point.

Net earnings from continuing operations increased by \$0.6 million or 12.2% from 2009 to \$5.3 million. The improvement was the result of an increase in EBIT of \$1.0 million or 12.9%, which was driven by higher sales in the cemetery division, and lower interest expense of \$0.2 million or 32.5% which were partially offset by higher income taxes of \$0.6 million or 25.8%.

Net earnings from discontinued operations decreased by \$0.2 million from 2009 to less than \$0.1 million due to a gain on the sale of one discontinued funeral branch operation in the first quarter of 2009.

Net earnings and earnings per share increased by \$0.4 million or 7.3% to \$5.3 million and \$0.03 to \$0.49 per share, respectively. The improvement was primarily due to an increase in EBIT of \$1.0 million, which was partially offset by higher income taxes of \$0.6 million.

The Company has two reportable segments: cemetery and funeral, which are strategic business units that offer different products and services. The nature of these products and services overlaps in some instances in the cemetery and funeral segments. However, these segments are managed separately and have different regulatory requirements. Management evaluates performance of the segments against the Company's strategic objectives and annual financial plans, and benchmarks performance of the segments against its large corporate competitors. For additional information regarding the Company's reportable segments, see Note 15 to the unaudited consolidated financial statements.

CEMETERY DIVISION

Cemetery sales in the first quarter of 2010 increased by \$4.5 million or 19.1% from 2009 to \$27.8 million. The increase in sales in the cemetery division was higher than historical increases. The average annual increase in cemetery sales from 2004 to 2009 was 4.7%.

Sales in the quarter, including finance charges and net of cancellation allowances, consisted of:

- \$9.5 million (2009 – \$8.5 million) of at-need sales of interment rights and deliveries of at-need merchandise and services;
- \$10.3 million (2009 – \$7.9 million) of pre-need sales of interment rights; and
- \$8.0 million (2009 – \$6.9 million) of pre-need sales of merchandise and services, recognized when merchandise was delivered or services were performed, including income earned on related pre-need trust funds.

The following is a breakdown of the \$4.5 million increase in cemetery sales (in \$millions):

<u>At-Need</u>	
Interment rights	0.1
Merchandise	0.8
Services	0.1
	<u>1.0</u>
 <u>Pre-Need</u>	
Interment rights	2.4
Merchandise	1.2
Services	(0.1)
	<u>3.5</u>
	<u><u>4.5</u></u>

The increase in at-need merchandise of \$0.8 million or 20.3% was due primarily to higher deliveries of upright monuments of \$0.4 million or 56.9% and higher deliveries of bronze memorials of \$0.2 million or 8.2%. The increase in monument deliveries was due to timing of delivery and an increase of 7.8% in contracts written in 2009 compared to 2008, which resulted in higher deliveries in the period. The increase in memorial deliveries was due to the timing of deliveries.

Sales of pre-need interment rights increased by \$2.4 million or 30.7% as follows:

Lots	0.6
Crypts	1.4
Niches	<u>0.4</u>
	<u>2.4</u>

The Company believes that the \$0.6 million or 15.7% increase in the sale of lots was mainly due to the following factors:

- improved prevailing economic conditions in the first quarter of 2010 compared to 2009;
- the forthcoming implementation of a harmonized sales tax in Ontario that has caused some cemetery customers to make their pre-need arrangements in advance of the transition date;
- the impact of new managers at certain branch locations; and
- incremental sales counsellors.

The \$1.4 million or 49.6% increase in crypt sales was due to a group sale of \$0.7 million in the first quarter of 2010 and the availability of new inventory at one cemetery branch operation. The \$0.4 million or 29.7% increase in niche sales was mainly due to the availability of new inventory as well as the factors noted above for the sale of lots.

The increase in pre-need merchandise of \$1.2 million or 21.1% was due to administrative projects undertaken in 2009 to contact customers and secure approval for manufacture of markers, timing of delivery and an increase in contracts written in prior years.

Deliveries of upright monuments and bronze memorials ("markers") can vary significantly from quarter to quarter since delivery is dependent on many factors, including, but not limited to:

- the timing of full payment by the customer;
- the amount of time it takes for customers to approve the manufacture and delivery of their marker;
- the amount of time it takes for orders to be submitted to the manufacturers;
- the amount of time it takes to manufacture the markers; and
- projects undertaken to contact customers and get markers manufactured and stored or installed.

In the first quarter of 2010, the number of interments performed by the Company increased by 3.4% to 4,259 and the number of cremations decreased by 0.5% to 3,726 compared to the first quarter of 2009. For comparative purposes, interments increased by 1.0% and cremations decreased by 3.4% in fiscal 2009 as compared to fiscal 2008. The average growth in interments and cremations over the five-year period from 2004 to 2009 was 0.7% and 0.1%, respectively.

Cemetery investment income for the first quarter of 2010 increased by \$0.1 million or 5.2% over 2009 to \$2.8 million due primarily to higher care fund income. Interest and dividend income on the care funds is recognized as earned and used to defray cemetery care and maintenance costs.

Interest and dividend income earned on pre-need cemetery merchandise and services trust funds increased by \$0.1 million or 4.1% to \$1.8 million in the first quarter of 2010 due to a higher average balance in the funds of \$14.9 million or 7.1%, which was partially offset by a decrease in the average rate of return from 3.3% to 3.2%. Interest and dividend income earned on the pre-need trust funds is deferred and recognized as sales revenue when the underlying merchandise is delivered or the service is performed.

Cemetery expenses for the first quarter of 2010 increased by \$3.2 million or 13.5% from 2009 as follows (in \$millions):

Cost of sales	2.1
Selling	0.8
Other	<u>0.3</u>
	<u>3.2</u>

Of the \$2.1 million or 26.5% increase in the cost of sales expense, \$1.5 million was due to the increase in sales and \$0.6 million was due to an increase in the cost of sales percentage for the first quarter of 2010 as compared to 2009. The cost of sales percentage for 2010 was 34.0%, which was 2.4 percentage points higher than the cost of sales percentage for 2009. The increase in the cost of sales percentage was due to the sales mix of

products and services sold. In particular, sales of crypts increased by \$1.5 million or 43.0% and crypts carry one of the highest cost percentages of all product categories. Monument sales also increased by \$0.9 million or 54.0% and monuments carry a higher than average cost of sales percentage.

Selling expenses increased by \$0.8 million or 10.1% due to higher obtaining costs of \$1.0 million or 21.4% as a result of an increase of 31.5% in contracts written in the first quarter of 2010 compared to 2009.

Excluding cost of sales and obtaining costs, cemetery expenses increased by \$0.1 million or 1.0% over the first quarter of 2009.

EBIT in the cemetery division for the first quarter of 2010 increased by \$1.4 million or 66.9% due mainly to higher sales, which were partially offset by an increase in the cost of sales and obtaining costs.

FUNERAL DIVISION

As at January 24, 2010, the Company wholly owned 82 funeral homes.

Funeral sales in the first quarter of 2010 increased by \$0.6 million or 2.0% from the first quarter of 2009 to \$31.6 million. The increase occurred mainly due to a \$0.4 million increase in sales from new operations, which was comprised of additional calls received at a funeral home in Brampton, Ontario as a result of the availability of a reception centre completed at a nearby cemetery in the third quarter of 2009. Sales of existing operations increased \$0.2 million or 0.6% due to a higher average sale per funeral service of 4.0%, which was partially offset by a decrease in the number of services performed of 3.3%. The Company believes that the decrease in the number of services performed is primarily due to a decrease in the death rate in certain markets. For comparative purposes, the average annual increase in the number of existing funeral home services from fiscal 2004 to 2009 was 1.5%. The increase in the average sale per funeral service was the result of price increases and an increase in the sale of floral arrangements, catering and ancillary merchandise. For comparative purposes, the average annual increase in the sale per funeral service from fiscal 2004 to 2009 was 3.0%. The cremation rate of 62.8% increased slightly from 62.0% for fiscal 2009. The average sale per traditional funeral service and cremation service increased by 4.0% and 5.2%, respectively, compared to fiscal 2009.

Sales in the period consisted of:

- \$21.1 million (2009 - \$21.0 million) of at-need sales of funeral merchandise and services; and
- \$10.5 million (2009 - \$10.0 million) from the fulfilment of funeral merchandise and services sales that were arranged on a pre-need basis.

Pre-need funeral contracts written in the first quarter of 2010 increased by \$3.7 million or 30.5% compared to a decrease of \$0.2 million or 1.9% in the first quarter of 2009. For comparative purposes, the average annual increase in pre-need funeral contracts written from 2004 to 2009 was 5.7%. The increase in the first quarter of 2010 was due to many factors including the one-Arbor initiative, which provides seamless service to our external customers and creates better collaboration internally, incremental sales counsellors, new on-site locations and new management at certain branch locations. The Company also believes that improved prevailing economic conditions as well as the forthcoming implementation of a harmonized sales tax in Ontario has also had a positive impact on pre-need funeral contracts being written.

Pre-need funeral contracts written under the trust program represented 31.2% (2009 – 39.1%) of total contracts written, while contracts written under the group annuity program represented 68.8% (2009 – 60.9%).

Investment and other income in the funeral division increased by \$0.6 million or 49.1% in 2010 due to higher annuity fees. The higher annuity fees resulted from an increase in contracts written under the annuity program in the first quarter of 2010 compared to 2009 of \$3.5 million or 47.4%, a lower percentage used for future chargebacks based on improved experience and an increase in the average payout percentage.

Interest and dividend income earned on the pre-need funeral funds in the first quarter of 2010 decreased by \$0.1 million or 5.1% to \$1.8 million compared to the first quarter of 2009 due to a reduction in the average balance in the funds of \$1.3 million or 0.6% as well as a lower annualized rate of return on the funds of 3.4% compared to 3.5%. The decrease in the average balance in the funds was due mainly to deliveries that exceeded new pre-need contracts written under the trust program. Interest and dividend income on the pre-need funeral funds is deferred and recognized as sales revenue when the underlying merchandise is delivered or the service is performed.

Funeral expenses in the first quarter of 2010 increased by \$1.3 million or 5.6%. A breakdown of the \$1.3 million increase in expenses by type of expenditure follows (in \$millions):

Cost of sales	0.2
Services	0.5
Facilities	(0.2)
Pre-need	0.6
Other	<u>0.2</u>
	<u>1.3</u>

The increase in services expenses of \$0.5 million or 4.4% was mainly due to higher employee costs as a result of annual salary and wage increases and incremental employees.

The increase in pre-need expenses of \$0.6 million or 27.0% was mainly due to higher obtaining and processing costs of \$0.5 million or 30.0% related to an increase in pre-need funeral contracts written in the first quarter of 2010 compared to 2009 of 30.5%.

Excluding pre-need obtaining and processing costs, funeral expenses increased by \$0.8 million or 3.8%.

EBIT in the funeral division decreased by \$0.1 million or 0.9% to \$9.4 million due to an increase in expenses of 5.6%, which exceeded a 3.7% increase in revenue. The 5.6% increase in expenses was driven by a 30.0% increase in obtaining and processing costs due to higher pre-need funeral contracts written in the period.

CORPORATE DIVISION

Corporate revenue, consisting of rental income from leasing a portion of the Company's head office building and interest income on the Company's bank accounts and notes receivable, decreased by less than \$0.1 million or 27.6% compared to the first quarter of 2009 due to lower interest income on the Company's bank accounts.

Corporate expenses increased by \$0.2 million or 6.0% in the first quarter of 2010 to \$4.3 million, which was mainly due to a non-recurring provincial sales tax liability of \$0.1 million that resulted from a provincial sales tax review in the first quarter of 2010 and a \$0.1 million or 7.6% increase in employee salaries and wages.

The loss in the corporate division increased by \$0.3 million or 7.5% to a loss of \$4.2 million mainly due to higher corporate expenses of \$0.2 million.

As a percentage of total Company revenue, corporate expenses decreased to 6.8% in the first quarter of 2010 from 7.0% for the same period of 2009. For comparative purposes, corporate expenses as a percentage of revenue averaged 6.4% from 2005 to 2009 on an annual basis.

CONSOLIDATED BALANCE SHEETS

Key financial indicators for the balance sheets as at January 24, 2010, and October 25, 2009, were as follows:

	January 24, 2010	October 25, <u>2009</u>
Current ratio	3.41:1	2.60:1
Working capital (in \$millions)	60.1	57.6
Debt to equity ratio	0.22:1	0.22:1
Long-term debt to EBITDA ⁽¹⁾	1.05:1	1.08:1
Interest coverage ratio ⁽¹⁾	8.40:1	8.20:1

⁽¹⁾ Bank covenant: long-term debt to EBITDA must be less than or equal to 3.50 and interest coverage ratio must equal or exceed 3.25.

The improvements in the current ratio and working capital were mainly due to a reduction in accounts payable and accrued liabilities of \$11.3 million that exceeded a reduction in cash of \$6.8 million.

Cash decreased by \$6.8 million mainly due to fixed asset additions of \$7.1 million and the payment of dividends of \$1.2 million that exceeded the increase in cash provided by operating activities of \$1.2 million.

Pre-need receivables and funds, including the current portion thereof, increased by \$5.5 million or 1.0% to \$541.4 million at January 24, 2010. The \$5.5 million increase included a fair value gain of \$2.8 million and a realized capital loss of \$0.1 million. Excluding these items, pre-need receivables and funds increased by \$2.8 million or 0.5%. This compared to an increase of \$1.4 million or 0.3% in the first quarter of 2009, excluding fair value adjustments and realized capital gains. The fair value gain of \$2.8 million was mainly related to a reduction in the spread between corporate bond yields and government bond yields, which increased the fair value of the corporate bonds portfolio.

Crypts and niches decreased by \$0.8 million or 2.1% to \$37.4 million due to the cost of inventory sold of \$2.5 million, which was partially offset by additions of \$1.7 million.

Fixed assets increased by \$1.6 million or 0.8% in the first quarter of 2010 to \$204.0 million due to additions of \$4.4 million (2009 - \$2.6 million), that were partially offset by depreciation of \$2.8 million (2009 - \$2.5 million). Of the \$4.4 million in additions, \$1.3 million was spent on maintenance capital and \$3.1 million was spent on new initiatives (2009 - \$1.3 million and \$1.3 million, respectively). The significant projects in the period included \$2.5 million for the partial construction of two new reception centres in Ottawa, and Toronto, Ontario.

Cemetery care funds and non-controlling interests in cemetery care funds increased by \$6.0 million or 3.1% in the first quarter of 2010, including a fair value gain in the period of \$2.7 million and a realized net capital gain of \$0.1 million. Excluding these items, cemetery care funds increased by \$3.2 million or 1.7% due to deposits made to the funds as a result of at-need and pre-need cemetery interment right sales. This compared to an increase of \$2.8 million or 1.5% in 2009, excluding fair value adjustments and realized net capital gains.

Accounts payable and accrued liabilities decreased by \$11.3 million or 33.7% as follows (in \$millions):

Trade accounts payables	5.9
Accrued liabilities	4.6
Other accounts payable	<u>0.8</u>
	<u>11.3</u>

The decrease in trade accounts payable was mainly related to lower payables for construction and development, inventory and expenses in the funeral division. The decrease in accrued liabilities was largely related to a reduction in accrued bonuses of \$2.7 million, vacation pay of \$1.1 million and payroll of \$0.6 million.

Deferred revenue and non-controlling interests in pre-need funds, plus the accumulated benefit of the pre-need funeral group annuity funds excluded from the balance sheet, was \$820.3 million compared to \$807.0 million at October 25, 2009, an increase of \$13.3 million or 1.6%. The \$13.3 million increase included a fair value gain of \$2.8 million on the pre-need trust funds and a realized net capital loss of \$0.1 million. The remaining increase was \$10.6 million or 1.3% (first quarter of 2009 – \$6.7 million or 0.9%) and represented deferral of revenue in the period in excess of amounts recognized upon delivery of merchandise and services.

CONSOLIDATED STATEMENTS OF CASH FLOWS

13 WEEKS ENDED JANUARY 24, 2010

Cash flow provided by operating activities of continuing operations was \$1.2 million in the first quarter of 2010 compared to cash used of \$3.3 million in the first quarter of 2009, representing an increase in cash of \$4.6 million. The increase was due mainly to an improvement in the net change in other operating balance sheet items ("net change") of \$3.5 million.

The improvement in the net change of \$3.5 million was primarily due to lower additions to developed land, crypts and niches of \$4.0 million, higher developed land, crypts and niches cost of sales of \$0.7 million and an improvement in the cash provided by accounts receivable of \$0.8 million. These factors were partially offset by a net increase in cash used for accounts payable and accrued liabilities of \$2.3 million and a net decrease in cash provided by instalment accounts receivable of \$1.5 million. Changes in other balances also had an impact.

Net cash used for investing activities of continuing operations increased by \$1.8 million or 15.5% in the first quarter of 2010. The increase was mainly due to higher additions to fixed assets of \$2.5 million, which were partially offset by \$1.0 million to acquire the land and building of an existing funeral home branch in the first quarter of 2009.

Net cash provided by financing activities of continuing operations decreased by \$0.7 million or 11.0% mainly due to an increase of \$1.2 million in dividend payments, which was timing related.

LIQUIDITY

The primary source of liquidity for the Company is cash flow from operations. In addition, the Company has revolving term loans with two financial institutions under similar terms and conditions. The total credit limit under the two facilities is \$125.0 million. The Company also has access to operating lines of credit of \$14.0 million. At January 24, 2010, the Company had access to unused operating lines of credit of \$12.5 million (October 25, 2009 – \$12.5 million) and unused floating rate debt facilities of \$80.0 million (October 25, 2009 – \$80.0 million). Total unused credit facilities as of January 24, 2010 were \$92.5 million (October 25, 2009 – \$92.5 million). The balance of unused term loans is subject to a standby fee, calculated daily. At January 24, 2010, there was \$1.5 million in letters of credit recorded against the operating facility (October 25, 2009 – \$1.5 million). The Company's debt to equity ratio at January 24, 2010 was 0.22:1 (October 25, 2009 – 0.22:1).

The principal liquidity requirements are to fund working capital, expenses, dividend payments, capital expenditures and cemetery burial space development costs. Working capital includes cash, accounts receivable, which includes extended payment terms particularly related to pre-need contracts in the cemetery division, and merchandise inventory for resale, which are partially offset by accounts payable and accrued liabilities.

Based on historical cash inflows and outflows, management believes that cash on hand and future cash flow from operating activities are sufficient to sustain ongoing operations as well as the routine maintenance and orderly replacement of the Company's fixed assets. For fiscal 2010, the Company has no plans to borrow additional debt on its bank term loans to fund ongoing operations or the orderly replacement of fixed assets based on its current cash position, expected cash from operations and projected capital and burial space inventory expenditures. However, the Company may borrow additional debt in fiscal 2010 to fund new initiatives, such as acquisitions, new reception centres and funeral homes, new cemetery land and significant additions and renovations to funeral homes. The requirement for new debt will depend on the timing of construction and development for internally generated projects and the availability of properties that can be acquired with attractive returns for acquisitions.

CAPITAL EXPENDITURES, CEMETERY BURIAL SPACE INVENTORY AND CONTRACTUAL COMMITMENTS

Following are the projects on which the Company had expended significant funds prior to January 24, 2010 that had not yet generated operating revenue.

- **Capital Memorial Gardens Chapel and Reception Centre:** As at January 24, 2010, the Company had spent \$4.4 million on this project. The Company estimates that another \$3.7 million will be spent to complete this project in 2010.
- **Glendale Memorial Gardens Chapel and Reception Centre:** As at January 24, 2010, the Company had spent \$2.2 million on this project. The Company estimates that an additional \$6.9 million will be spent to complete this project and that the project will be complete in the first quarter of 2011.

The Company had committed to the following expenditures for capital and cemetery burial space inventory at January 24, 2010 (in \$millions), which the Company expects to spend within the next two years:

Cemetery burial space inventory	5.1
Maintenance capital expenditures	1.5
New funeral home initiatives	1.2
New reception centres	<u>7.7</u>
	<u>15.5</u>

The Company is also contractually committed to funeral inventory purchases of \$39.1 million during the period from February 1, 2008 to January 31, 2013. From February 1, 2008 to January 24, 2010, the Company had purchased \$17.2 million under this commitment. The Company anticipates funding these expenditures from existing cash and cash from operations generated in 2010.

Following is the Company's planned capital and cemetery burial space inventory spending for the remainder of fiscal 2010 (in \$millions):

New initiatives	26.6
Cemetery burial space inventory	17.4
Maintenance capital expenditures	<u>13.6</u>
	<u>57.6</u>

Estimates of future capital and cemetery burial space spending may change positively or negatively depending on factors including, but not limited to, the availability of labour and materials, delays in the construction planning and approval process and future changes in the nature or details of the projects.

UNAUDITED SUMMARY OF QUARTERLY RESULTS

(\$millions, except per share amounts)	For the 13 weeks ended							
	First Quarter		Fourth Quarter		Third Quarter		Second Quarter	
	Jan-24 2010	Jan-25 2009	Oct-25 2009	Oct-26 2008	Jul-26 2009	Jul-27 2008	Apr-26 2009	Apr-27 2008
Revenue	64.1	58.3	64.5	59.0	61.4	61.5	60.0	58.0
Net earnings from continuing operations	5.3	4.7	4.6	5.7	5.9	5.4	4.8	5.3
Net earnings	5.3	4.9	4.5	5.8	5.6	5.3	4.9	5.6
Basic and diluted earnings per share from continuing operations ⁽¹⁾	\$0.49	\$0.44	\$0.43	\$0.53	\$0.55	\$0.50	\$0.45	\$0.49
Basic and diluted earnings per share ⁽¹⁾	\$0.49	\$0.46	\$0.42	\$0.54	\$0.52	\$0.49	\$0.46	\$0.52

⁽¹⁾ All earnings per share figures presented are applicable to both Class A and Class B shares.

Revenue

Revenue in the first quarter of 2010 was affected by an improvement of \$4.5 million or 19.1% in cemetery sales and an improvement of \$0.6 million or 2.0% in funeral sales. The increase in cemetery sales was mainly due to higher pre-need crypt sales and higher deliveries of bronze memorials and upright monuments ("markers"). The increase in crypts sales was primarily due to a group sale of \$0.7 million and the availability of new inventory at one cemetery branch operation. The higher deliveries of bronze memorials and markers were mainly due to administrative projects undertaken in 2009 to contact customers and secure approval for manufacture of markers, an increase in contracts written in prior years and timing of delivery. The Company also believes that the increase in sales was due to improved prevailing economic conditions, the forthcoming implementation of a harmonized sales tax in Ontario, the impact of new managers at certain branch locations and incremental sales counsellors.

Revenue in the fourth quarter of 2009 was affected by an improvement of \$3.2 million or 11.9% in cemetery sales and an improvement of \$1.9 million or 6.8% in funeral sales. The increase in cemetery sales was mainly due to higher deliveries of pre-need bronze memorials and markers and higher crypt sales that occurred primarily due to the availability of new inventory at one cemetery branch operation. The higher deliveries of markers was mainly a result of administrative projects undertaken to contact customers and secure approval for manufacture of markers that were fully-paid in prior years. The increase in funeral sales was mainly due to an increase of \$0.4 million in new operations and an increase of 4.6% in the average sale per funeral service of existing funeral operations.

Net Earnings From Continuing Operations and Earnings Per Share From Continuing Operations

Net earnings from continuing operations and earnings per share from continuing operations were higher in the first quarter of 2010 compared to the first quarter of 2009 primarily due to higher cemetery sales of \$4.5 million or 19.1%, which were partially offset by an increase in cemetery expenses of \$3.2 million or 13.5% and higher income taxes of \$0.6 million.

Net earnings from continuing operations and earnings per share from continuing operations were higher in the fourth quarter of 2008 compared to the fourth quarter of 2009 as a result of an adjustment of \$1.5 million in 2008 from recovery of refundable dividend taxes that were previously expensed, due to an increase in the annual dividend.

Net Earnings and Earnings Per Share

Net earnings and earnings per share did not vary significantly from net earnings from continuing operations and earnings per share from continuing operations.

OUTSTANDING SHARES

The Company has an unlimited number of Preferred Shares, Class A Voting Shares and Class B Non-Voting Shares authorized for issue. The Class A and Class B shares have identical rights and privileges, except that the Class A shares are voting. In certain circumstances, if an offer is made by the Company or a third party to purchase Class A shares from each holder in Ontario, each Class B share is convertible into one Class A share. Subsequent to January 24, 2010, the Company repurchased 100,000 Class A Voting shares at \$23.25 per share under the normal course issuer bid that was announced on September 3, 2009. At March 9, 2010, the Company had issued 2,425,497 Class A shares and 8,188,246 Class B shares for \$1.7 million and \$73.7 million respectively.

EVENTS AND UNCERTAINTIES

Current economic market conditions

The Company has given consideration to how the current economic and financial market uncertainty has affected or will affect the Company's performance, resources, estimates, liquidity and other areas. Due to the nature of the Company's products and services, in particular the inevitable need for them and the cumulative impact on current period results from pre-need contracts written in prior years, the Company has not experienced a decline in sales or pre-need contracts written. For the 13 weeks ended January 24, 2010, cemetery sales and pre-need cemetery contracts written increased by 19.1% and 31.5%, respectively, and pre-need funeral contracts written increased by 30.5%. Additionally, the average sale per service in the funeral division increased by 4.0%. A reduction in contracts written could impact revenue recognized in the future and a prolonged negative economic environment could result in price sensitivity and/or a reduction in the products and services purchased.

Management has been monitoring various factors that could indicate negative trends resulting from general economic conditions including the following:

- **Potential for Increasing Receivables/Uncollectible Accounts:** The Company noted that at-need cemetery contracts with less than 25% of the contract amount paid and at least one overdue payment cycle represented 7.8% of the receivable balance or \$0.4 million at January 24, 2010 (October 25, 2009-8.5% and \$0.4 million). The Company has considered this change in its estimate of the provision for uncollectible accounts, which represents 45.9% of the balance of at-need cemetery contracts with less than 25% of the contract amount paid and at least one overdue payment cycle at January 24, 2010.
- **Potential Goodwill Impairment:** There were no incremental goodwill impairment issues identified in the period. However, the Company will continue to monitor its under-performing reporting units.
- **Potential Decreases in Values of Funds:** At January 24, 2010, the pre-need trust funds had \$0.3 million in unrealized losses in the U.S. equity funds while the care funds had \$1.0 million in net unrealized losses in its foreign corporate bond holdings. The Company reviews the investments within its trust funds on an ongoing basis and, based on consultation with its investment managers, does not believe there are any going concern issues. However, the Company continues to monitor the performance of individual investments. To date, there have been no changes made to valuation techniques with respect to the fair market values of the pre-need trust and care funds.
- **Potential supply constraints:** The Company does not anticipate, and has not experienced, a material impact on costs or any constraints on the supply of products or services required to support the operation of the business.

Based on outcomes to date, the Company has not made changes to either its overall strategy or strategic objectives as a result of prevailing conditions. A substantial unfavourable change in the factors above, either

individually or in the aggregate, could have a material adverse effect on the Company's financial condition, results of operations and cash flows.

Seasonality

While the death care industry is fairly stable and predictable, the Company's at-need business and pre-need deliveries of some merchandise and services can be affected by seasonal fluctuations in the death rate. Death rates are generally higher in the winter months. The Company's pre-need cemetery sales of interment rights can also have seasonal fluctuations, whereby sales are generally lower in the winter and summer months.

Regulation

During the third quarter of 2009, the Ontario Ministry of Consumer Services released revised draft regulations pertaining to the Funeral, Burial and Cremation Services Act, 2002 (formerly Bill 209), to be reviewed for comment. The Company has been informed that the regulations are in their final stages of development and Ministry officials have signalled their intent to proclaim the legislation in fiscal 2010. The Company anticipates that full implementation of the regulations will occur within twelve months of proclamation and does not anticipate that the cost of compliance will be significant.

Environmental

Over the last several years, various federal, provincial and municipal government agencies have released environmental legislation that has caused the Company to incur extra costs in order to comply with the legislation. Specifically, the ban on pesticides has increased the labour costs to maintain properties and in the case of new crematorium buildings, additional monitoring equipment and stack testing is required. To date, however, the increase in costs incurred has not been significant. The Company continues to monitor its compliance and programs with respect to other existing environmental standards and regulations as well as potential new standards and regulations across Canada, and believes that costs will be incurred to comply with these regulations. However, the Company estimates that the one-time cost of compliance with known regulations will be approximately \$0.6 million and that the incremental annual cost of compliance will not be significant. The Company believes that environmental legislation will continue to evolve.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

With respect to internal control over financial reporting, during the Company's most recent interim period, there were no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

March 4, 2010

Arbor Memorial Services Inc.

UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS

<i>For the 13 weeks ended (in thousands of dollars, except per share amounts)</i>	January 24, 2010	<i>January 25, 2009 ⁽¹⁾</i>
Revenue		
Sales	59,363	54,297
Investment and other income (note 7)	4,715	4,037
	64,078	58,334
Expenses		
Operating (note 5)	51,206	46,669
Corporate	4,342	4,095
Other	(25)	(5)
	55,523	50,759
Earnings before interest expense and income taxes	8,555	7,575
Interest expense	386	572
Earnings before income taxes	8,169	7,003
Income taxes (note 9)	2,891	2,299
Net earnings from continuing operations	5,278	4,704
Net earnings from discontinued operations (note 10)	2	217
Net earnings	5,280	4,921
Basic and diluted earnings per share (note 8)		
Continuing operations	\$0.49	\$0.44
Discontinued operations	-	0.02
Basic and diluted earnings per share	\$0.49	\$0.46

⁽¹⁾ Certain figures provided for 2009 have been restated to conform with the current period's presentation - see note 10.

UNAUDITED CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

<i>For the 13 weeks ended (in thousands of dollars)</i>	January 24, 2010	<i>January 25, 2009</i>
Retained earnings, beginning of period	127,546	112,853
Net earnings for the period	5,280	4,921
Refundable dividend taxes received	393	-
Dividends	(1,179)	(1,179)
Refundable dividend taxes paid	(151)	(90)
Retained earnings, end of period	131,889	116,505

See accompanying notes to the unaudited consolidated financial statements.

Arbor Memorial Services Inc.

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

<i>For the 13 weeks ended (in thousands of dollars)</i>	January 24, 2010	January 25, 2009
Net earnings	5,280	4,921
Other comprehensive loss:		
Net change in losses on effective portion of derivatives designated as cash flow hedges net of income taxes of \$36 in 2010 and \$381 in 2009 (note 6)	(79)	(806)
Net change in unrealized gains associated with available for sale securities of the pre-need trust funds:		
Change in unrealized gains associated with available for sale securities of the pre-need trust funds, net of income taxes of (\$855) in 2010 and (\$1,726) in 2009	1,947	3,761
Change in unrealized gains associated with available for sale securities of the pre-need trust funds attributable to non-controlling interests and deferred revenue, net of income taxes of \$855 in 2010 and \$1,726 in 2009	(1,947)	(3,761)
	-	-
Net change in unrealized gains and losses associated with available for sale securities of the cemetery care funds:		
Change in unrealized gains and losses associated with available for sale securities of the cemetery care funds, net of income taxes of (\$819) in 2010 and \$119 in 2009	1,864	(258)
Change in unrealized gains and losses associated with available for sale securities of the cemetery care funds attributable to non-controlling interests, net of income taxes of \$819 in 2010 and (\$119) in 2009	(1,864)	258
	-	-
Other comprehensive loss	(79)	(806)
Comprehensive income	5,201	4,115

UNAUDITED CONSOLIDATED STATEMENTS OF ACCUMULATED OTHER COMPREHENSIVE LOSS

<i>For the 13 weeks ended (in thousands of dollars)</i>	January 24, 2010	January 25, 2009
Accumulated other comprehensive loss, beginning of period	(1,208)	(1,268)
Other comprehensive loss for the period	(79)	(806)
Accumulated other comprehensive loss, end of period	(1,287)	(2,074)

See accompanying notes to the unaudited consolidated financial statements.

Arbor Memorial Services Inc.

UNAUDITED CONSOLIDATED BALANCE SHEETS

<i>In thousands of dollars</i>	As at January 24, 2010	October 25, 2009 ⁽¹⁾
Assets		
Current assets		
Cash	9,996	16,811
Accounts receivable	19,704	20,037
Pre-need receivables, current portion (note 3)	40,349	41,230
Merchandise inventories (note 5)	12,941	12,794
Income taxes receivable	1,112	964
Prepaid expenses	552	1,299
Future income taxes, current portion	331	368
	84,985	93,503
Notes receivable	700	700
Crypts and niches (note 5)	37,357	38,173
Cemetery land (note 5)	32,130	32,300
Fixed assets	204,002	202,366
Pre-need receivables and funds (note 3)	501,100	494,711
Stored merchandise	14,303	14,089
Other assets	131	131
Goodwill	50,467	50,467
Intangible assets	1,893	1,911
Future income taxes	15,070	16,323
Cemetery care funds (note 4)	200,206	194,229
	1,142,344	1,138,903
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	22,196	33,490
Long-term debt, current portion	1,125	750
Future income taxes, current portion	1,599	1,708
	24,920	35,948
Long-term debt	43,826	44,205
Other liabilities	18,716	18,265
Deferred revenue (note 14)	206,593	208,280
Non-controlling interests in pre-need funds (note 14)	439,150	432,876
Future income taxes	2,943	3,374
	736,148	742,948
Non-controlling interests in cemetery care funds	200,206	194,229
Shareholders' equity		
Share capital (note 8)	75,388	75,388
Retained earnings	131,889	127,546
Accumulated other comprehensive loss	(1,287)	(1,208)
	130,602	126,338
	205,990	201,726
	1,142,344	1,138,903

⁽¹⁾ Certain figures provided for 2009 have been restated to conform with the current period's presentation - see note 14.

See accompanying notes to the unaudited consolidated financial statements.

Arbor Memorial Services Inc.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>For the 13 weeks ended (in thousands of dollars)</i>	January 24, 2010	January 25, 2009 ⁽¹⁾
Cash provided by (used for)		
Operating activities		
Net earnings from continuing operations	5,278	4,704
Add (deduct) items not affecting cash:		
Depreciation and amortization	2,806	2,519
Other income	(25)	(5)
Future income taxes (note 9)	786	581
Net change in other operating balance sheet items (note 11)	(7,607)	(11,129)
Net cash provided by (used for) continuing operations	1,238	(3,330)
Net cash provided by discontinued operations	2	50
Investing activities		
Additions to fixed assets	(7,082)	(4,564)
Acquisition (note 2)	-	(1,014)
Additions to cemetery land held for future development	(9)	(16)
Proceeds on disposal of assets	25	19
Change in pre-need funds	(3,446)	(3,544)
Change in cemetery care funds	(3,202)	(2,751)
Net cash used for continuing operations	(13,714)	(11,870)
Net cash provided by discontinued operations	-	1,710
Financing activities		
Repayment of long-term debt	(4)	(23)
Dividends paid	(1,179)	-
Change in non-controlling interests in pre-need funds	3,640	3,632
Change in non-controlling interests in cemetery care funds	3,202	2,751
Net cash provided by continuing operations	5,659	6,360
Net cash used for discontinued operations	-	(47)
Decrease in cash	(6,815)	(7,127)
Cash, beginning of period	16,811	14,768
Cash, end of period	9,996	7,641
Supplementary information		
Income taxes paid	2,017	2,565
Interest paid	346	607

⁽¹⁾ Certain figures provided for 2009 have been restated to conform with the current period's presentation - see notes 10 and 14.

See accompanying notes to the unaudited consolidated financial statements.

Arbor Memorial Services Inc.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
For the 13 weeks ended January 24, 2010 and January 25, 2009

1. BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and are consistent with the accounting policies used to prepare the 2009 annual consolidated financial statements, except as otherwise noted herein. While management considers the interim disclosures presented to be adequate, these consolidated financial statements do not include all of the disclosures required for annual financial statements and should be read in conjunction with the Company's 2009 annual consolidated financial statements.

While the death care industry is fairly stable and predictable, the Company's at-need business and pre-need deliveries of some merchandise and services can be affected by seasonal fluctuations in the death rate. Death rates are generally higher in the winter months. The Company's pre-need cemetery sales of interment rights can also have seasonal fluctuations, whereby sales are generally lower in the winter and summer months.

2. ACQUISITION

In the first quarter of 2009, the Company purchased the land and building of an existing funeral branch operation, which were previously leased, for \$1.0 million.

3. PRE-NEED RECEIVABLES AND FUNDS

	January 24, 2010	<i>October 25, 2009</i>
	<i>(\$000)</i>	
Pre-need cemetery trust funds	241,799	236,918
Pre-need funeral trust funds	205,960	204,560
	447,759	441,478
Instalment accounts receivable	71,743	72,389
Pre-need group annuity funds	21,947	22,074
	541,449	535,941
Less: current portion of instalment of accounts receivable	40,349	41,230
	501,100	494,711

The consolidated balance sheets do not include pre-need funeral and cemetery contracts that will be funded by third-party insurers under group annuity programs, upon delivery of pre-need merchandise and services, where the Company is not the policyholder. At January 24, 2010, the accumulated benefit of all such contracts sold by the Company's sales counsellors was \$174.6 million (October 25, 2009 - \$165.8 million).

The trust funds consist of the following investments:

	Fair Value		Cost	
	January 24, 2010	<i>October 25, 2009</i>	January 24, 2010	<i>October 25, 2009</i>
	<i>(\$000)</i>		<i>(\$000)</i>	
Cash	3,586	4,390	3,586	4,390
Term deposits	240,449	237,634	230,957	228,331
Fixed income:				
Canadian government bonds	45,840	43,117	43,666	41,285
Canadian corporate bonds	112,661	111,591	104,801	105,289
	158,501	154,708	148,467	146,574

	<i>Fair Value</i>		<i>Cost</i>	
	<i>January 24, 2010</i>	<i>October 25, 2009</i>	<i>January 24, 2010</i>	<i>October 25, 2009</i>
	<i>(\$000)</i>		<i>(\$000)</i>	
Equities:				
Canadian preferred shares	4,017	3,948	3,845	3,845
Canadian common shares	22,146	21,922	16,243	16,440
U.S. common shares	2,169	2,102	2,473	2,513
	28,332	27,972	22,561	22,798
Equity/bond funds	16,891	16,774	16,815	16,815
	447,759	441,478	422,386	418,908

4. CEMETERY CARE FUNDS

Cemetery care funds consist of the following investments:

	<i>Fair Value</i>		<i>Cost</i>	
	<i>January 24, 2010</i>	<i>October 25, 2009</i>	<i>January 24, 2010</i>	<i>October 25, 2009</i>
	<i>(\$000)</i>		<i>(\$000)</i>	
Cash	221	567	221	567
Term deposits	6,118	4,978	6,118	4,978
Fixed income:				
Canadian government bonds	46,988	45,956	44,634	44,091
Canadian corporate bonds	84,896	82,701	79,393	78,342
Foreign corporate bonds	3,484	3,236	4,532	4,532
Canadian mortgage backed securities	16,598	17,311	16,570	17,520
Canadian asset backed securities	19,767	19,456	19,104	19,104
	171,733	168,660	164,233	163,589
Equities:				
Canadian preferred shares	3,025	2,972	2,926	2,926
Canadian common shares	18,905	16,861	18,844	16,988
U.S. common shares	204	191	207	207
	22,134	20,024	21,977	20,121
	200,206	194,229	192,549	189,255

5. INVENTORY

The cost of inventory recognized in operating expenses as cost of sales for the 13 weeks ended January 24, 2010 and January 25, 2009 included the following:

	<i>January 24, 2010</i>	<i>January 25, 2009</i>
	<i>(\$000)</i>	
Merchandise inventories	7,885	7,079
Crypts and niches and cemetery land	2,927	2,088
	10,812	9,167

6. FINANCIAL INSTRUMENTS

Derivative Financial Instruments

As of January 24, 2010, the Company's use of interest rate swap agreements was limited to three (October 25, 2009 – three) interest rate swaps with a Canadian chartered bank, whereby the Company fixed a portion of its term loan financing at interest rates ranging from 4.4% to 5.0%. At January 24, 2010, these swaps had a total notional amount of \$20.0 million (October 25, 2009 – \$20.0 million). The swaps expire in 2012 and 2014. Swap costs in the 13 weeks ended January 24, 2010 were \$0.2 million (13 weeks ended January 25, 2009 – \$0.1 million) and are included in interest expense. Losses due to non-performance by the counterparty are not anticipated due to their high credit standing.

All of the Company's interest rate swaps are designated as cash flow hedges. At January 24, 2010, the critical terms of the swaps did not match the terms of the underlying floating rate debt. Therefore, the hypothetical derivative method was used to perform a quantitative, retrospective and prospective assessment of the effectiveness of the swaps. This methodology involved regression analysis of historical interest rates for the floating rate portion of the swaps and historical interest rates for the underlying debt. The result of the analysis was that the fair value of the cash flows from the interest rates of the swaps was highly effective at offsetting the variability in cash flows from the interest rates of the underlying debt. Therefore, hedge accounting was used to record the swaps and related activity for the year.

Fair Value of Financial Instruments

Financial instruments measured at fair value in the Company's consolidated balance sheets include pre-need trust funds, cemetery care funds and interest rate swap agreements.

Financial instruments included in Level 1 are determined by reference to unadjusted quoted prices in active markets for identical assets and liabilities accessed at the measurement date. The Company's financial instruments classified as Level 1 securities at January 24, 2010 include cash, money market funds, common stock, certain fixed income securities and equity/bond funds. Financial instruments included in Level 2 represent securities that are estimated using inputs that are based on observable market data for a comparable ("similar") asset or liability. The Company's financial instruments classified as Level 2 securities at January 24, 2010 include GIC's, asset backed securities, mortgage backed securities and interest rate swap contracts. Financial instruments included in Level 3 are estimated based on an input that is unobservable in the market and that reflects the entity's own assumptions about what market participants would assume in pricing the asset or liability. As at January 24, 2010, the Company did not have any financial instruments that had fair values determined by Level 3 inputs.

The following table indicates the fair value hierarchy of the inputs used to measure the fair value of the pre-need trust funds, cemetery care funds and interest rate swap agreements at January 24, 2010. There were no reclassifications between levels in the hierarchy compared to October 25, 2009.

	Quoted Market Prices in Active Markets (Level 1)	Significant Other Observable (Level 2)	Significant Unobservable (Level 3)	January 24, 2010 Fair Market Value	October 25, 2009 Fair Market Value
			(\$000)		
Pre-need trust funds	447,759	-	-	447,759	441,478
Cemetery care funds	163,841	36,365	-	200,206	194,229
Interest rate swap agreements	-	(1,894)	-	(1,894)	(1,779)
	611,600	34,471	-	646,071	633,928

7. INVESTMENT AND OTHER INCOME

	13 weeks ended January 24 and January 25									
	<i>Pre-Need</i>		<i>Pre-Need</i>		<i>Cemetery</i>		<i>Other</i>		<i>Consolidated</i>	
	<i>Cemetery Funds</i>		<i>Funeral Funds</i>		<i>Care Funds</i>					
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
	(\$000)									
Realized earnings of funds:										
Interest and dividends ⁽¹⁾	1,818	1,747	1,663	1,752	2,333	2,207	-	-	5,814	5,706
Realized gains	103	-	78	64	206	835	-	-	387	899
Realized losses	(189)	-	(86)	-	(114)	(464)	-	-	(389)	(464)
Trust expenses	(61)	(52)	(61)	(56)	(86)	(73)	-	-	(208)	(181)
	1,671	1,695	1,594	1,760	2,339	2,505	-	-	5,604	5,960
Deferred revenue	(13)	(24)	-	-	-	-	-	-	(13)	(24)
Trust expenses ⁽²⁾	61	52	61	56	86	73	-	-	208	181
Non-controlling interests in funds	(1,719)	(1,723)	(1,655)	(1,816)	(115)	(392)	-	-	(3,489)	(3,931)
	-	-	-	-	2,310	2,186	-	-	2,310	2,186
Fee income	503	488	1,779	1,193	-	-	-	-	2,282	1,681
Other	-	-	-	-	-	-	123	170	123	170
	503	488	1,779	1,193	2,310	2,186	123	170	4,715	4,037

⁽¹⁾ Includes interest income of \$5.4 million (2009 - \$5.4 million).

⁽²⁾ Trust expenses are reclassified to operating expenses in the financial statements.

8. SHARE CAPITAL

Authorized:

- Unlimited number of Preferred Shares
- Unlimited number of Class A Voting Shares
- Unlimited number of Class B Non-Voting Shares

Issued and outstanding:

	<i>Number of Shares</i>		<i>Amount</i>	
	<i>January 24, 2010</i>	<i>October 25, 2009</i>	<i>January 24, 2010</i>	<i>October 25, 2009</i>
	(\$000)			
Class A Voting shares	2,525,497	2,525,497	1,734	1,734
Class B Non-Voting shares	8,188,246	8,188,246	73,654	73,654
	10,713,743	10,713,743	75,388	75,388

The Class A and Class B shares have identical rights and privileges, except that the Class A shares are voting. In certain circumstances, if an offer is made by the Company or a third party to purchase Class A shares from each holder in Ontario, each Class B share is convertible into one Class A share. The weighted average number of shares outstanding for the 13 weeks ended January 24, 2010 was 10,713,743 (13 weeks ended January 25, 2009 – 10,713,743).

9. INCOME TAXES

Income tax expense:

Income tax expense for the 13 weeks ended January 24, 2010 and January 25, 2009 consisted of the following:

	<u>2010</u>	<u>2009</u>
		(\$000)
Current tax expense	2,105	1,718
Future income tax expense relating to the origination and reversal of temporary differences	295	455
Future income tax expense resulting from changes in future tax rates	491	126
	<u>2,891</u>	<u>2,299</u>

Effective income tax rate:

The reconciliation of the Company's effective income tax rate is as follows:

	<u>2010</u>	<u>2009</u>
		(%)
Combined basic federal and provincial income tax rate	30.9	31.9
Change in the basic tax rate resulting from:		
Dividends	(1.7)	(1.2)
Impact of future tax changes	5.9	1.8
Meals and entertainment	0.3	0.4
Other items	-	(0.1)
Effective income tax rate	<u>35.4</u>	<u>32.8</u>

10. DISCONTINUED OPERATIONS

A branch operation that met the criteria for being classified as a discontinued operation in the fourth quarter of 2007 was sold in the first quarter of 2009 for net cash proceeds of \$1.8 million. The after-tax gain on the sale was \$0.1 million, which included the disposal of goodwill having a carrying value of nil.

In the second quarter of 2009, the assets of five funeral branch operations met the criteria for being classified as discontinued operations. The decision to sell these branches was made as these operations did not fit into the Company's long-term strategic direction. In addition, marginal performance was a factor in the case of two of these branch operations and possible future earnings reductions was a factor in the case of the remaining three branch operations. The sale of these branch operations was completed in the third quarter of 2009 for cash proceeds of \$2.4 million. The after-tax gain on the sale of these branch operations was \$0.1 million, including the disposal of goodwill having a carrying value of \$0.7 million.

In the fourth quarter of 2009, the Company sold a parcel of undeveloped cemetery land. The sale resulted in an after-tax loss of \$0.5 million. The decision to sell the property was made since the potential for the property to be developed into saleable cemetery land was evaluated as unlikely.

Revenue associated with discontinued operations for the first quarter of 2010 was \$0.1 million (first quarter of 2009 – \$0.5 million) and the net earnings for the first quarter of 2010 were less than \$0.1 million (first quarter of 2009 –\$0.2 million).

11. NET CHANGE IN OTHER OPERATING BALANCE SHEET ITEMS

	<u>January 24,</u> <u>2010</u>	<u>January 25,</u> <u>2009</u>
		(\$000)
Accounts receivable	333	(421)
Instalment accounts receivable	646	2,144
Stored merchandise	(214)	(191)
Developed land, crypt and niche cost of sales	2,769	2,044
Additions to developed land, crypts and niches	(1,774)	(5,766)
Accounts payable and accrued liabilities	(8,636)	(6,293)
Income taxes receivable	(148)	(669)
Deferred revenue	(1,761)	(2,207)
Other liabilities	336	198
Other changes	842	32
	<u>(7,607)</u>	<u>(11,129)</u>

12. CONTRACTUAL COMMITMENTS

At January 24, 2010, the Company was contractually committed to capital and cemetery burial space inventory expenditures of \$15.5 million (October 25, 2009 – \$16.4 million), which the Company expects to spend within the next two years. The Company is also contractually committed to funeral inventory purchases of \$39.1 million during the period from February 1, 2008 to January 31, 2013. From February 1, 2008 to January 24, 2010, the Company had purchased \$17.2 million under this commitment.

13. SUBSEQUENT EVENT

Subsequent to January 24, 2010, the Company repurchased 100,000 Class A Voting shares at \$23.25 per share under the normal course issuer bid that was announced on September 3, 2009.

14. RESTATEMENT OF PRIOR PERIOD DEFERRED REVENUE AND NON-CONTROLLING INTERESTS IN PRE-NEED FUNDS

The Company has restated the comparative amounts in the Consolidated Balance Sheets to correct an immaterial misclassification between deferred revenue and non-controlling interests in pre-need funds of \$18.3 million. The restatement of these balances also affected the net change in other operating balance sheet items and the change in non-controlling interests in pre-need funds in the Consolidated Statements of Cash Flows by \$0.1 million. The restatement had no impact on the Consolidated Statements of Earnings, shareholder's equity or current or total liabilities.

15. SEGMENT DISCLOSURE

The Company has two reportable segments: cemetery and funeral. The corporate segment has been provided principally to reconcile the reportable segments to consolidated results. The cemetery segment sells interment rights and cemetery merchandise and services. The funeral segment sells funeral merchandise and services. The corporate segment's responsibilities include strategy development, human resource management, capital investment decisions, accounting and finance and performance monitoring of the cemetery and funeral operations.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on earnings before income taxes.

The Company's reportable segments are strategic business units that offer different products and services. The nature of these products and services overlap in some instances in the cemetery and funeral segments. However, these segments are managed separately and have different regulatory requirements.

All of the Company's revenues are derived in Canada and all of the Company's capital assets and goodwill are located in Canada.

	<i>For the 13 weeks ended January 24 and January 25</i>							
	<i>Cemetery</i>		<i>Funeral</i>		<i>Corporate</i>		<i>Consolidated</i>	
	<i>2010</i>	<i>2009</i>	<i>2010</i>	<i>2009</i>	<i>2010</i>	<i>2009</i>	<i>2010</i>	<i>2009</i>
Sales ⁽¹⁾	27,808	23,346	31,555	30,951	-	-	59,363	54,297
Investment and other income ⁽¹⁾	2,813	2,674	1,779	1,193	123	170	4,715	4,037
Revenue	30,621	26,020	33,334	32,144	123	170	64,078	58,334
Depreciation and amortization ⁽¹⁾	1,068	897	1,382	1,284	356	338	2,806	2,519
Earnings (loss) before interest expense and income taxes ⁽¹⁾	3,385	2,028	9,389	9,472	(4,219)	(3,925)	8,555	7,575
Interest expense	-	-	-	-	386	572	386	572
Earnings (loss) before income taxes ⁽¹⁾	3,385	2,028	9,389	9,472	(4,605)	(4,497)	8,169	7,003
Identifiable assets ⁽²⁾	680,031	669,233	431,899	433,885	30,414	35,785	1,142,344	1,138,903
Capital expenditures	3,178	1,733	695	610	551	212	4,424	2,555
Acquisition	-	-	-	1,014	-	-	-	1,014
Developed land, crypt and niche additions	1,774	5,766	-	-	-	-	1,774	5,766
Cemetery land held for future development additions ⁽¹⁾	9	16	-	-	-	-	9	16
Pre-need contracts written	21,059	16,010	15,703	12,031	-	-	36,762	28,041

⁽¹⁾ Figures provided for 2009 have been restated to conform with the current year's presentation - see note 10.

⁽²⁾ Identifiable assets shown for 2009 as at October 25.