

Third Quarter Report

**Nine Months Ended
July 31, 2006**



**ARBOR
MEMORIAL
SERVICES INC.**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis has been prepared for the three and nine months ended July 31, 2006 and includes material information available up to August 31, 2006. The financial data provided has been prepared in accordance with Canadian generally accepted accounting principles 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 Memorial Services Inc., including the Company's 2005 Annual Information Form and the 2005 Annual Report, can be found on SEDAR at www.sedar.com.

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 such differences include, but are not limited to, those discussed elsewhere in this Third Quarter Report, those discussed under "Risks, Events and Uncertainties" in the Company's 2005 Annual Report and in the Company's 2005 Annual Information Form under "Description of the Business – Risk Factors". 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.

Some of the discussion of operating performance is based on earnings before interest expense and income taxes ("EBIT"). This measure excludes the impact of interest expense and income taxes as disclosed in the statements of earnings. The Company uses EBIT to assess its operating results, as the Company believes it is important to assess the cemetery, funeral, and corporate activities without these non-operating components. The Company believes that this measure provides readers with a supplemental basis for evaluating the Company's performance. EBIT is a non-GAAP measure that does not have any standardized meaning prescribed by GAAP and may therefore not be comparable to similar measures presented by other companies.

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

NEW ACCOUNTING POLICY

Under CICA Handbook Section 1581 Business Combinations, intangible assets are recognized apart from goodwill when the assets result from contractual or other legal rights or the assets are capable of being separated or divided from the acquired enterprise and sold, transferred, licensed, rented or exchanged. In the purchase price allocation of the acquisition described in note 2 to the consolidated interim financial statements included in this Third Quarter Report, the Company recognized a future benefit related to the pre-need funeral contracts acquired and the value of the trade name. The future benefit related to the pre-need funeral contracts represented deferred obtaining costs that the Company did not have to incur to obtain the pre-need contracts. This benefit is being expensed based on estimated timing of contract delivery. The value of the trade name acquired was calculated using the Capitalized Royalty Income Method, whereby the trade name was valued by reference to the amount of royalty income it could generate if it was licensed, in an arm's-length transaction, to a third party. The value of the trade name is not subject to amortization as the trade name has an indefinite life.

The value of the future benefit related to the pre-need funeral contracts acquired will be tested for impairment by comparing the carrying value of the benefit, and other long-lived assets related to the acquisition, to the future undiscounted cash flows whenever impairment indicators arise. If the carrying value is greater than the undiscounted future cash flows, a fair value is calculated and any shortfall in the fair value compared to net book value is recorded as a provision for impairment of assets. The value of the trade name will be reviewed annually

by comparing the carrying value and the fair value, or more frequently if impairment indicators arise, to determine if an impairment loss should be recognized. A provision will be made if the value of the trade name is considered impaired.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JULY 31, 2006 COMPARED TO THE THREE MONTHS ENDED JULY 31, 2005

TOTAL COMPANY RESULTS

Following is a breakdown of total revenue for the third quarter of 2006 and 2005.

	<u>2006</u>		<u>2005</u>	
	<u>\$000</u>	<u>% of Total</u>	<u>\$000</u>	<u>% of Total</u>
Sales				
Cemetery	24,345	45.5	23,266	47.8
Funeral	25,106	46.9	21,688	44.6
Corporate	151	0.3	139	0.3
	<u>49,602</u>	<u>92.7</u>	<u>45,093</u>	<u>92.7</u>
Investment and other income				
	<u>3,908</u>	<u>7.3</u>	<u>3,548</u>	<u>7.3</u>
	<u>53,510</u>	<u>100.0</u>	<u>48,641</u>	<u>100.0</u>

Revenue for the quarter ended July 31, 2006 increased by \$4.9 million or 10.0% to \$53.5 million. Sales increased by \$4.5 million or 10.0%, while investment and other income grew by \$0.4 million or 10.1%.

Sales in the cemetery division increased by \$1.1 million or 4.6%, while sales in the funeral division increased by \$3.4 million or 15.8%. Of the \$3.4 million increase in the funeral division, \$2.3 million was related to new operations. Sales from existing operations in the funeral division increased by \$1.1 million or 5.1%, which resulted from an increase in calls of 1.2% and an increase in the average sale per call of 3.9%.

Investment and other income in the third quarter of 2006 increased by \$0.4 million or 10.1% to \$3.9 million due mainly to an increase in the fees received under the pre-need funeral annuity program of \$0.3 million or 42.0% and an increase in cemetery care fund income of \$0.1 million or 6.4%. Excluding new operations, the fees received under the pre-need funeral annuity program increased by 21.4% due to an increase in sales and an effort to move more pre-need funeral contracts from the trust program to the annuity program.

Operating expenses increased by \$3.6 million or 9.2% to \$43.0 million in the third quarter of 2006 compared to the same period in 2005. Cemetery division expenses increased by \$1.1 million or 4.7%. Funeral division expenses increased by \$2.6 million or 15.1%, of which \$1.9 million was related to new operations. Excluding new operations, funeral division expenses increased by \$0.7 million or 4.1%.

Corporate expenses decreased by \$0.3 million or 9.0% to \$3.4 million, which was due mainly to a decrease in employee benefit costs, a decrease in the corporate bonus accrual and a decrease in the legal fee accrual based on work incurred to date.

Earnings before interest expense and income taxes for the third quarter of 2006 were \$7.2 million, which represented an increase of \$1.6 million or 28.1% compared to the third quarter of 2005. The \$1.6 million increase was attributable to \$0.1 million improvement in cemetery operations, a \$0.5 million or 7.9% improvement in existing funeral operations, additional earnings of \$0.6 million related to new funeral operations and a decrease in the loss from the corporate division of \$0.4 million.

Interest expense included interest on floating-rate bank term debt, a capital lease and the cost of the Company's interest rate swap contracts. Interest expense increased by \$0.3 million or 31.6% to \$1.3 million in the third quarter of 2006 due to new floating-rate bank term debt of \$19.9 million that was borrowed at the beginning of the first quarter to finance the acquisition of 7 funeral homes and higher floating interest rates. The average long-term debt balance for the period increased by \$18.7 million or 24.2%.

The average rate of interest on long-term debt for the period was 5.4% compared to 5.1% in 2005. The increase in the rate was due to higher floating interest rates and occurred despite a decrease in the proportion of fixed rate debt in the period. The average proportion of fixed-rate debt for the third quarter of 2006 was 49% compared to 68% for the third quarter of 2005.

Excluding swap costs, the weighted-average rate of interest on long-term debt for the quarter was 4.9%, compared to 3.3% in the third quarter of 2005. The swaps caused the Company's interest expense to be higher in 2006 by \$0.2 million (2005 - \$0.3 million) than would otherwise have been the case if the Company had maintained all floating-rate debt.

Income taxes for the third quarter of 2006 resulted in an effective tax rate of 28.9%, compared to 32.6% in the third quarter of 2005. The 3.7 percentage point decrease in the rate was mainly due to a change in income tax rates used to calculate future income taxes and a lower large corporations tax (LCT). The lower LCT was due to the Federal capital tax being repealed effective January 1, 2006. An increase in the combined basic federal and provincial income tax rate of 2.0 percentage points partially offset the positive impact of these items and was due to a change in the provincial allocation of income and a higher rate of tax in Quebec. Scheduled reductions in the federal income tax rate and the elimination of the corporate surtax had the biggest impact on the decrease in the rate for purposes of calculating future income taxes, which were reduced by \$0.2 million in the quarter.

Net earnings and earnings per share in the third quarter of 2006 were \$4.2 million and \$0.39 respectively compared to \$3.1 million and \$0.30 per share in the third quarter of 2005. The increase of 33.2% was mainly attributable to improved earnings in the funeral division as a result of sales from new operations and higher sales from existing operations.

CEMETERY DIVISION

Cemetery sales in the third quarter of 2006 increased by \$1.1 million or 4.6% over the third quarter of 2005 to \$24.3 million. Sales in the quarter, including finance charges and net of cancellation allowances, consisted of:

- \$8.4 million (2005 - \$8.4 million) of pre-need sales of interment rights;
- \$6.2 million (2005 - \$6.1 million) of pre-need sales of merchandise and services, recognized at the point when merchandise was delivered or services were performed, including income earned on related pre-need trust funds;
- \$9.7 million (2005 - \$8.7 million) of at-need sales of interment rights and deliveries of at-need merchandise and services.

Following is a breakdown of the \$1.1 million increase in total cemetery sales (in \$000):

<u>At-Need</u>	
Interment rights	0.2
Merchandise	0.6
Services	<u>0.2</u>
	<u>1.0</u>
<u>Pre-Need</u>	
Interment rights	-
Merchandise	-
Services	<u>0.1</u>
	<u>0.1</u>
	<u>1.1</u>

Of the \$0.6 million increase in the delivery of at-need merchandise, \$0.3 million was due to higher deliveries of bronze memorials, while \$0.2 million was due to higher deliveries of upright monuments. The increase in delivery of bronze memorials of \$0.3 million or 16.0% in the quarter was timing-related since deliveries for the nine months ended July 31, 2006 were only \$0.2 million or 3.0% higher than deliveries in the same period of 2005 and 3.0% is within the Company's expectations for annual growth. The increase in deliveries of upright monuments of \$0.2 million or 16.0% was partially timing-related and also related to an increase in at-need monument contracts written in the second half of 2005 compared to the same period of 2004 of 15.0%, which contributed to higher deliveries in the quarter.

Pre-need cemetery sales contracts written in the quarter were \$18.2 million, compared to \$17.3 million in 2005. This represented an increase of \$0.9 million or 5.3%. While pre-need merchandise and services contracts and certain interment right contracts that do not meet minimum deposit requirements are not included immediately in the Company's reported sales, they do contribute to building future market share and future reported sales.

In the third quarter of 2006, the number of interments performed by the Company increased by 1.9% to 4,625 and the number of cremations increased by 0.8% to 3,415. For comparative purposes, interments and cremations in

fiscal 2005 both increased by 0.2% and interments and cremations in fiscal 2004 increased by 2.5% and 1.7% respectively on a comparable basis.

Cemetery investment income, which includes investment income on cemetery care funds and fees received from the deposit of pre-need cemetery funds, increased by \$0.1 million or 2.9% to \$2.4 million. Interest and dividend income earned on the cemetery care funds increased by 6.4% over the third quarter of 2005 to \$2.0 million due to an increase in the average balance outstanding of \$11.0 million or 7.8% and despite a reduction in the average rate of return of 0.1 of a percentage point. Fees received from the deposit of pre-need cemetery funds decreased by 12.1% due to reinvestment of a portion of the funds at lower rates.

Interest and dividend income on pre-need cemetery merchandise and services trust funds earned in the quarter increased by \$0.1 million or 3.0% due to a higher average balance in the funds of \$13.5 million or 8.1% and despite a reduction in the annualized average rate of return of 0.2 of a percentage point. While interest and dividend income on the care funds is recognized as earned in order to defray cemetery care and maintenance costs, 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 quarter increased by \$1.1 million or 4.7% as follows (in millions):

Cost of sales	0.2
Selling	0.3
Care and maintenance	0.2
Reception centres including depreciation	0.2
Other	0.2
	<u>1.1</u>

The increase in cost of sales expense of \$0.2 million was due to the increase in sales. The cost of sales percentage for the quarter decreased from 46.2% in 2005 to 45.1% in 2006 mainly due to a decrease in the provision for estimated losses on historical pre-need merchandise contracts where the original sale amount plus earned investment income was less than the cost to purchase the merchandise at July 31, 2006. Excluding this adjustment, the cost of sales percentage was 46.0%.

The \$0.3 million or 7.0% increase in selling expenses was due to higher employee costs and managerial commissions of \$0.1 million or 3.5% and higher marketing expenses of \$0.2 million or 33.7%. The increase in marketing expenses was due mainly to new granite memory walls for veterans at 11 cemeteries for \$0.1 million and increased mailing costs, among other items.

The \$0.2 million or 4.1% increase in care and maintenance expenses was mainly due to higher employee costs, particularly salaries and wages for permanent employees and temporary and part-time wages.

Reception centre costs increased by \$0.2 million due to the new reception centre constructed at Mount Lawn Memorial Gardens in Whitby, Ontario that opened in March 2006.

Earnings before interest expense and income taxes in the cemetery division increased by \$0.1 million or 2.7% in the third quarter of 2006 compared to 2005 due mainly to the increase in sales.

FUNERAL DIVISION

Funeral sales in the third quarter of 2006 increased by \$3.4 million or 15.8% over the third quarter of 2005 to \$25.1 million. The improvement was attributable to a \$2.3 million increase in sales from new operations and a \$1.1 million or 5.1% increase in sales from existing operations. New operations in the quarter included 7 funeral homes in the Ottawa, Ontario area that were acquired in the first quarter of 2006, a new funeral home in Markham, Ontario that opened in June 2005 and additional calls received at a funeral home in Ajax, Ontario as a result of the availability of a reception centre completed at a nearby cemetery in 2006. The 5.1% increase in sales from existing operations was due to a 3.9% increase in the average sale per funeral service and a 1.2% increase in the number of calls.

Sales from existing operations in the quarter consisted of \$15.2 million (2005 - \$14.4 million) of at-need sales of funeral merchandise and services and \$7.4 million (2005 - \$7.1 million) from the fulfilment of merchandise and services sales that were arranged on a pre-need basis. Pre-need funeral contracts written in the quarter totalled \$13.4 million compared to \$10.6 million in the third quarter of 2005, an increase of \$2.8 million or 26.0%. Of the \$2.8 million increase, \$2.0 million was related to the new funeral homes acquired in the Ottawa, Ontario area.

Excluding the contracts written related to the funeral homes in Ottawa, pre-need funeral contracts written increased by \$0.8 million or 7.5%.

Investment and other income in the funeral division increased by \$0.2 million or 23.2% to \$1.3 million in the third quarter of 2006. Of the \$0.2 million increase, more than half was related to new operations. Excluding the impact of new operations, investment and other income increased by \$0.1 million or 9.4%. The improvement was mainly attributable to an increase in sales of pre-need contracts written under the group annuity program due to an increase in pre-need funeral sales and an effort to move more pre-need funeral contracts from the trust program to the annuity program.

Funeral expenses in the third quarter of 2006 increased by \$2.6 million or 15.1%, of which \$1.9 million was related to new operations and \$0.7 million was related to existing operations. A breakdown of the \$0.7 million increase in existing operations expenses by type of expenditure follows (in \$millions):

Services	0.5
Facilities	0.1
Motor equipment	0.1
Depreciation	0.1
Administrative	(0.2)
Other	0.1
	<u>0.7</u>

The \$0.5 million or 6.7% increase in existing funeral home services expenses was mainly due to an increase in employee costs due to annual increases of permanent employees, an increase in temporary and part-time labour costs and an increase in employee benefit costs.

Earnings before interest expense and income taxes in the funeral division increased by \$1.1 million or 19.1%, to \$6.8 million in the third quarter of 2006. Of the \$1.1 million increase, \$0.6 million was due to new operations. Excluding new operations, earnings improved by \$0.5 million or 8.9% due to the 5.1% increase in sales, the \$0.1 million or 9.4% increase in investment and other income and a lower increase in expenses of 4.1% as compared to the increase in sales.

CORPORATE DIVISION

Corporate revenue, consisting of rental income from leasing a portion of the Company's head office building and interest on the Company's bank accounts, short-term investments and a mortgage receivable, was \$0.4 million in the third quarter of 2006 compared to \$0.3 million in the third quarter of 2005 due mainly to an increase in mortgage receivable interest.

Corporate expenses decreased by \$0.3 million or 9.0% to \$3.4 million, which was due mainly to a decrease in employee benefit costs, a decrease in the corporate bonus accrual and a decrease in the legal fee accrual based on work incurred to date. As a percentage of total Company revenue, corporate expenses for the third quarter of 2006 decreased to 6.3% from 7.7% in 2005 due to the 9.0% decrease in expenses and the 10.0% increase in total Company revenue.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED JULY 31, 2006 COMPARED TO THE NINE MONTHS ENDED JULY 31, 2005

TOTAL COMPANY RESULTS

Following is a breakdown of total revenue for the first nine months of 2006 and 2005.

	<u>2006</u>		<u>2005</u>	
	<u>\$000</u>	<u>% of Total</u>	<u>\$000</u>	<u>% of Total</u>
Sales				
Cemetery	69,257	43.2	66,375	44.8
Funeral	79,336	49.5	70,532	47.6
Corporate	448	0.3	431	0.3
	<u>149,041</u>	<u>93.0</u>	<u>137,338</u>	<u>92.7</u>
Investment and other income	<u>11,167</u>	<u>7.0</u>	<u>10,883</u>	<u>7.3</u>
	<u>160,208</u>	<u>100.0</u>	<u>148,221</u>	<u>100.0</u>

Revenue for the nine months ended July 31, 2006 was \$160.2 million. This represented a \$12.0 million or 8.1% increase over the first nine months of 2005.

Sales in the cemetery division increased by \$2.9 million or 4.3%, while sales in the funeral division increased by \$8.8 million or 12.5%. Of the \$8.8 million increase in the funeral division, \$6.8 million was related to new operations. Sales from existing operations in the funeral division increased by \$2.0 million or 2.9%, which was due to an increase in the average sale per funeral service.

Investment and other income in the first nine months of 2006 increased by \$0.3 million or 2.6% due to improvements in care fund income, fees received under the pre-need funeral annuity program and interest received under a mortgage receivable in the corporate division.

Operating expenses increased by \$8.7 million or 7.6% to \$124.1 million in the first nine months of 2006 compared to the same period in 2005. Cemetery division expenses increased by \$1.9 million or 2.9% due mainly to increases in selling expenses, care and maintenance expenses and reception centre costs. Funeral division expenses increased by \$6.9 million or 13.2%, of which \$5.6 million was related to new operations. Excluding new operations, funeral division expenses increased by \$1.3 million or 2.5%.

Corporate expenses increased by \$0.4 million or 3.9% to \$10.4 million. The increase was mainly due to a higher depreciation expense as a result of the implementation of a new operating system in 2005 and higher employee costs.

Earnings before interest expense and income taxes for the first nine months of 2006 were \$25.7 million, which represented an increase of \$2.9 million or 12.5% compared to the same period of 2005. The \$2.9 million increase was due to a \$1.1 million improvement in cemetery operations, a \$0.5 million or 2.4% improvement in existing funeral operations and additional earnings of \$1.5 million related to new funeral operations. These improvements were partially offset by an increase in the loss from corporate operations of \$0.3 million or 3.1%.

Interest expense included interest on floating-rate bank term debt, a capital lease and the cost of the Company's interest rate swap contracts. Interest expense increased by \$0.7 million or 23.6% to \$3.8 million in the first nine months of 2006 due to new floating-rate bank term debt of \$19.9 million that was borrowed at the beginning of the period to finance the acquisition of 7 funeral homes and higher floating rates of interest. The weighted average long-term debt balance increased by \$19.0 million or 24.6%.

The weighted average rate of interest on long-term debt for the period was 5.2% compared to 5.3% in 2005. The reduction in the weighted average rate was due to a lower proportion of fixed-rate debt in 2006 compared to 2005. The weighted-average proportion of fixed-rate debt for the nine months ended July 31, 2006 was 50% compared to 69% in the first nine months of 2005.

Excluding swap costs, the weighted-average rate of interest on long-term debt was 4.4% (2005 – 3.4%). The swaps caused the Company's interest expense to be higher in 2006 by \$0.6 million (2005 - \$1.1 million) than would otherwise have been the case if the Company had maintained all floating-rate debt.

Income taxes for the first nine months of 2006 resulted in an effective tax rate of 32.0%, compared to 32.9% in the first nine months of 2005. The 0.9 percentage point decrease in the rate was mainly due to a change in income tax rates used to calculate future income taxes, which decreased the effective rate by 1.1 percentage points and a lower large corporations tax (LCT). The lower LCT was due to the Federal capital tax being repealed effective January 1, 2006. Scheduled reductions in the federal income tax rate and the elimination of the corporate surtax had the biggest impact on the decrease in the rate for purposes of calculating future income taxes, which were reduced by \$0.2 million in the period. A higher combined basic federal and provincial income tax rate and a lower recovery of a prior year over-provision in 2006 compared to 2005 partially offset the positive impact of these items. The combined basic federal and provincial income tax rate was higher in 2006 compared to 2005 by 0.5 of a percentage point due to a change in the provincial allocation of income and a higher rate of tax in Quebec.

Net earnings and earnings per share in the first nine months of 2006 were \$15.0 million and \$1.42 per share respectively compared to \$13.4 million and \$1.26 per share in the same period of 2005. The increase of 12.4% was attributable to an improvement in operating earnings of the cemetery and funeral divisions.

CEMETERY DIVISION

Cemetery sales in the first nine months of 2006 increased by \$2.9 million or 4.3% over the first nine months of 2005 to \$69.3 million. Sales, including finance charges and net of cancellation allowances, consisted of:

- \$24.0 million (2005 – \$24.1 million) of pre-need sales of interment rights;
- \$19.5 million (2005 – \$18.4 million) of pre-need sales of merchandise and services, recognized at the point when merchandise was delivered or services were performed, including income earned on related pre-need trust funds;
- \$25.8 million (2005 – \$23.9 million) of at-need sales of interment rights and deliveries of at-need merchandise and services.

Following is a breakdown of the \$2.9 million increase in total cemetery sales (in \$millions):

<u>At-Need</u>	
Interment rights	-
Merchandise	1.3
Services	<u>0.6</u>
	<u>1.9</u>
<u>Pre-Need</u>	
Interment rights	(0.1)
Merchandise	0.9
Services	<u>0.2</u>
	<u>1.0</u>
	<u>2.9</u>

Of the \$1.3 million increase in the delivery of at-need merchandise, \$0.6 million was due to higher deliveries of upright monuments. The increase in deliveries of upright monuments was due to sales of \$0.1 million that resulted from an administrative project that identified upright monuments delivered in prior years and higher at-need monument contracts written in the second half of 2005 compared to the same period of 2004 of 15.0%, which contributed to higher deliveries in 2006.

Of the remaining increase in deliveries of at-need merchandise of \$0.7 million, \$0.3 million occurred as a result of an administrative project that identified merchandise and services delivered in prior years. The remaining increase of \$0.4 million represented a 3.9% improvement, which is in line with the Company's growth expectations.

Of the \$0.6 million increase in deliveries of at-need services, \$0.2 million occurred as a result of administrative projects that identified merchandise and services delivered in prior years. In addition, \$0.1 million of the variance occurred as a result of a reallocation of bronze memorial and upright monument maintenance fund fees from bronze memorial and upright monument sales to the services category. The remaining increase of \$0.3 million or 5.8% was mainly due to pricing increases for cremation fees that occurred over the prior fifteen months.

The decrease in sales of pre-need burial spaces was due to lower group sales in the first nine month of 2006 compared to the same period of 2005 of \$0.4 million.

The \$0.9 million increase in pre-need merchandise sales was mainly due to an increase in the delivery of upright monuments. The increase in the delivery of upright monuments was related to an increase in monument contracts written at a branch in Oakville, Ontario that opened a new reception centre in 2004. In addition, overall pre-need monument sales contracts written increased in the first nine months of 2006 over the same period of 2005 by \$0.5 million or 16.9% and contracts written in fiscal 2005 increased over 2004 by 5.7%. Monuments, on average, are delivered to customers in 2 years from the date the contract is written.

The impact of all administrative projects on net earnings in the first nine months of 2006 was \$0.4 million, compared to \$0.3 million in the first nine months of 2005.

Pre-need cemetery sales contracts written in the first nine months of 2006 increased by \$1.3 million or 2.7% to \$51.9 million. While pre-need merchandise and services contracts and certain interment right contracts that do not meet minimum deposit requirements are not included immediately in the Company's reported sales, they do contribute to building future market share and future reported sales.

In the first nine months of 2006, the number of interments performed by the Company decreased by 1.3% to 12,617 and the number of cremations increased by 0.8% to 10,783. For comparative purposes, interments and

cremations in fiscal 2005 both increased by 0.2% and interments and cremations in fiscal 2004 increased by 2.5% and 1.7% respectively on a comparable basis.

Cemetery investment income increased by \$0.1 million or 1.7% over the first nine months of 2005 to \$7.0 million due to an increase in care fund income. Interest and dividend income earned on the care funds increased by 3.3% due to a higher average balance in the funds of \$10.9 million or 7.9% and despite a decrease in the annualized average rate of return on the funds from 5.5% in the first nine months of 2005 to 5.3% in 2006.

Interest and dividend income on pre-need cemetery merchandise and services trust funds earned in the period increased by \$0.3 million or 4.8% due to a higher average balance in the funds of \$13.6 million or 8.3% and despite a lower annualized average rate of return on the funds from 4.3% in 2005 to 4.2% in 2006. While interest and dividend income on the care funds is recognized as earned in order to defray cemetery care and maintenance costs, 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 nine months of 2006 increased by \$1.9 million or 2.9% as follows (in millions):

Cost of sales	0.2
Selling	0.7
Care and maintenance	0.5
Reception centres including depreciation	0.4
Other	0.1
	<u>1.9</u>

Cost of sales expense was higher than 2005 by only \$0.2 million despite a \$2.9 million increase in sales due to a \$0.3 million change in the estimated cost of providing monument death date inscriptions to pre-need customers, a \$0.3 million change in other cost of sales accruals based on revised estimates and a change in the mix of sales. In particular, at-need services sales were \$0.7 million or 10.9% higher than 2005 and this category carries a lower cost of sales percentage. Excluding the adjustment to the estimated cost of monument death date inscriptions and the reduction in other accruals, the cost of sales percentage was 46.4% compared to 47.1% in the first nine months of 2005.

The \$0.7 million or 5.5% increase in selling expenses was due to higher employee costs and managerial commissions of \$0.3 million or 3.9%, higher marketing expenses of \$0.3 million or 17.1% and an increase of \$0.1 million in other selling expenses. The increase in marketing expenses was due to a new marketing campaign utilizing billboards for \$0.1 million, new granite memory walls for veterans at 11 cemeteries for \$0.1 million and increased mailing costs of 13.3%.

The \$0.5 million or 3.4% increase in care and maintenance expenses was due to higher employee costs, particularly salaries and wages, outside labour services and temporary and part-time wages.

Reception centre costs increased by \$0.4 million due to the new reception centre constructed at Mount Lawn Memorial Gardens in Whitby, Ontario that opened in March 2006.

Earnings before interest expense and income taxes in the cemetery division increased by \$1.1 million or 11.6% in the first nine months of 2006 compared to 2005 due mainly to the increase in sales and the positive adjustments to cost of sales expense.

FUNERAL DIVISION

Funeral sales in the first nine months of 2006 increased by \$8.8 million or 12.5% over the first nine months of 2005 to \$79.3 million. The improvement was attributable to a \$6.8 million increase in sales from new operations and a \$2.0 million or 2.9% increase in sales from existing operations. New operations in the period included 7 funeral homes in the Ottawa, Ontario area that were acquired at the beginning of the period, a new funeral home in Markham, Ontario that opened in June 2005 and additional calls received at a funeral home in Ajax, Ontario as a result of the availability of a reception centre completed at a nearby cemetery in 2006. The 2.9% increase in sales from existing operations was due to an improvement in the average sale per funeral service. Existing home calls were consistent with 2005.

Sales from existing operations in the period consisted of \$48.5 million (2005 - \$48.6 million) of at-need sales of funeral merchandise and services and \$23.8 million (2005 - \$21.7 million) from the fulfilment of merchandise and services sales that were arranged on a pre-need basis. Pre-need funeral contracts written in the first nine months

of 2006 totalled \$38.1 million compared to \$33.3 million in 2005, an increase of \$4.7 million or 14.2%. Of the \$4.7 million increase, \$3.6 million was related to the new funeral homes acquired in the Ottawa, Ontario area. Excluding these contracts, pre-need funeral contracts written increased by 3.6%.

Investment and other income in the funeral division increased by \$0.1 million or 2.1% to \$3.5 million in the first nine months of 2006. The improvement was attributable to an increase of \$0.3 million in investment income of new operations. Investment income of existing operations decreased by \$0.2 million due to a decrease in the fees received from the deposit of pre-need funeral funds under both the group annuity program and the trust program. The decrease in fees received under the group annuity program was the result of a lower average payout rate based on the type of sales made and a higher estimate of the rate of cancellation based on historical experience. The decrease in the fees received under the trust program was due to a lower annualized rate of return due to reinvestment of a portion of the funds at lower rates.

Funeral expenses in the period increased by \$6.9 million or 13.2%, of which \$5.6 million was related to new operations. Excluding the impact of new operations, expenses increased by \$1.3 million or 2.5%. A breakdown of the \$1.3 million increase in expenses of existing operations by type of expenditure follows (in \$millions):

Cost of sales	0.3
Services	0.8
Motor equipment	0.2
Pre-need expenses	0.2
Other	(0.2)
	<u>1.3</u>

The increase in the cost of sales expense was related to the increase in sales. The cost of sales percentage decreased by 0.1 of a percentage point. The \$0.8 million or 3.5% increase in services expense was mainly due to an increase in employee costs of 4.0%.

Earnings before interest expense and income taxes in the funeral division increased by \$2.0 million or 9.1%, to \$24.1 million in the first nine months of 2006. Of the \$2.0 million increase, \$1.5 million was attributable to new operations. Earnings of existing operations improved by \$0.5 million or 2.4%.

CORPORATE DIVISION

Corporate revenue, consisting of rental income from leasing a portion of the Company's head office building and interest on the Company's bank accounts, short-term investments and mortgage receivable, was \$1.1 million in the first nine months of 2006 compared to \$1.0 million in the first nine months of 2005 due mainly to an increase in mortgage receivable interest.

Corporate expenses increased by \$0.4 million or 3.9% to \$10.4 million in the period due to an increase in depreciation of \$0.4 million as a result of the implementation of the Company's new operating system in the third quarter of 2005 and an increase in employee costs of \$0.3 million. As a percentage of total Company revenue, corporate expenses for the first nine months of 2006 decreased to 6.5% from 6.8% in the same period of 2005.

CONSOLIDATED BALANCE SHEETS

Key financial indicators for the balance sheets as at July 31, 2006 and October 31, 2005 are as follows:

	July 31, 2006	October 31, 2005
Current ratio (ratio:1)	3.00	2.54
Working capital (in \$millions)	50.5	46.7
Long-term debt to equity ratio (ratio:1)	0.51	0.44
Long-term debt to EBITDA ratio (ratio: 1) ⁽¹⁾	2.20	1.91
Interest coverage ratio (ratio:1) ⁽¹⁾	5.55	5.60

(1) Bank covenant: Long-term debt to EBITDA ratio must be less than or equal to 3.5 and Interest coverage ratio must equal or exceed 3.25 on an annualized basis.

Working capital increased by \$3.8 million from October 31, 2005 due to a decrease in current liabilities of \$5.1 million compared to a decrease in current assets of \$1.3 million. The decrease in current liabilities was due to a decrease in accounts payable and accrued liabilities and long-term debt, current portion, while the decrease in current assets was due to a reduction in cash from \$11.0 million at October 31, 2005 to \$8.0 million at July 31, 2006. The decreases in accounts payable and accrued liabilities and long-term debt, current portion as well as the decrease in cash were partially offset by increases in other current balances.

The long-term debt to equity ratio and the long-term debt to EBITDA bank covenant increased by 0.07:1 and 0.29:1 respectively due to new debt of \$19.9 million that was borrowed in the first quarter of 2006 to partially finance the acquisition of 7 funeral homes for \$24.0 million.

Accounts receivable arising from at-need cemetery sales were paid on average within 45 days at July 31, 2006 (October 31, 2005 – 47 days). Accounts receivable arising from at-need funeral sales were paid on average within 31 days at July 31, 2006 (October 31, 2005 – 31 days).

Prepaid expenses were \$0.8 million at July 31, 2006 compared to \$0.5 million at the end of the 2005 fiscal year. The reason for the increase was that prepaid insurance premiums are paid at the beginning of the fiscal year and fully charged to expense by the end of the year.

Pre-need receivables and funds, including the current portion thereof, increased by \$28.6 million or 6.3% to \$480.2 million at the end of the third quarter, of which \$18.5 million was related to new operations. The remaining increase of \$10.1 million or 2.2% represented contributions to the funds plus realized investment income at a higher rate than the removal of funds due to deliveries of contracts in the period.

The accumulated benefit of pre-need funeral contracts at July 31, 2006 that will be funded by third-party insurers upon delivery of pre-need merchandise and services, where the Company is not the policyholder, was \$83.6 million, compared to \$67.0 million at October 31, 2005. Of the \$16.6 million increase, \$2.3 million was related to new operations. The accumulated benefit of these contracts is not included in the Company's balance sheet.

The sum of pre-need receivables and funds and the off-balance sheet pre-need funeral contracts that will be funded by third-party insurers, but excluding the funds related to new operations, at July 31, 2006 increased by \$24.3 million or 4.7%.

Cemetery care funds increased by \$8.0 million or 5.5% in the first nine months of 2006 due to deposits to the funds resulting from collection of amounts related to cemetery burial space sales. Comparatively, cemetery care funds increased by \$7.4 million or 5.5% in the first nine months of 2005.

Crypts and niches decreased by \$1.8 million or 6.9% to \$24.4 million due to crypts and niches sold in the period of \$5.6 million, offset by additions of \$3.8 million. The \$3.8 million in additions (first nine months of 2005 – \$2.6 million) included:

- \$1.2 million for a mausoleum expansion at Highland Memory Gardens in Toronto, Ontario;
- \$0.9 million for a new interior niche building at Fairhaven Memorial Gardens in Moncton, New Brunswick;
- \$0.9 million for a mausoleum expansion at Capital Memorial Gardens in Ottawa, Ontario; and
- \$0.8 million in other expenditures.

Fixed assets in the first nine months of 2006 increased by \$15.6 million, due to \$14.5 million in assets acquired in the first quarter in connection with the purchase of 7 funeral homes in the Ottawa, Ontario area and \$8.4 million in other additions, which were partially offset by \$7.3 million in depreciation. The \$8.4 million in non-acquisition additions included the following:

- \$2.9 million for cemetery maintenance capital fixed assets, including the development or renovation of cemetery sales offices and service buildings;
- \$2.4 million for funeral maintenance capital fixed assets;
- \$1.4 million for further development of a new on-site reception centre and cemetery sales office at Mount Lawn Memorial Gardens in Whitby, Ontario, which opened for business in March 2006;
- \$0.6 million for corporate division maintenance capital fixed assets, including computer hardware and software;
- \$0.6 million for further development of a funeral home building addition in Edmonton, Alberta; and
- \$0.5 million for other fixed asset additions.

The cemetery fixed asset additions included the following significant projects:

- \$0.3 million for development of a new road at Glenview Memorial Gardens, a cemetery that opened in the fourth quarter of 2002;
- \$0.4 million for development of a new sales office at Highland Hills Memorial Gardens, a cemetery that opened at the beginning of fiscal 1999; and
- \$0.3 million for development of a sales office expansion at Valley View Memorial Gardens in Surrey, British Columbia, among other items.

Goodwill increased by \$10.8 million as a result of the acquisition of 7 funeral homes in the period. Note 2 to the consolidated interim financial statements provides details of the purchase allocation.

Mortgage receivable: During the year, the term of the mortgage receivable was extended from April 30, 2007 to January 30, 2008. One-half of the mortgage receivable is due on April 30, 2007 and the remainder is due on January 30, 2008. A lump sum interest payment of \$0.8 million was made effective January 31, 2006 and a second interest payment of \$0.5 million is scheduled to be made on January 31, 2007. The payments represent interest rates of 6.0% and 6.5% respectively calculated on the blended principal amount of the mortgage.

Deferred obtaining costs and stored merchandise increased by \$2.7 million or 4.0% in the period, due to a higher amount of commissions deferred in the period compared to commissions recognized as a result of deliveries of the underlying contract merchandise and services of \$2.4 million and an increase in stored merchandise of \$0.3 million or 2.8%

Intangible and other assets increased in the first nine months of 2006 by \$2.2 million due mainly to intangible assets established on the acquisition of 7 funeral homes in the first quarter. These intangible assets of \$2.1 million represent a future benefit related to the pre-need funeral contracts acquired and the value of the trade name. Other assets increased by \$0.1 million.

Accounts payable and accrued liabilities decreased from October 31, 2005 by \$6.2 million as follows (in \$millions):

Trade accounts payables	3.4
Accrued liabilities	1.5
Other accounts payable	<u>1.3</u>
	<u>6.2</u>

The decrease in trade accounts payable was due mainly to lower construction and development payables and accruals of \$2.5 million at July 31, 2006 compared to October 31, 2005. Accrued liabilities were higher at October 31, 2005 due to a full year of accrued amounts, such as bonuses and vacation pay that were paid subsequent to the 2005 year-end. For comparative purposes, accounts payable and accrued liabilities at July 31, 2005 decreased by \$8.7 million from October 31, 2004.

Long-term debt at July 31, 2006, including the current portion, was \$96.1 million compared to \$76.2 million at the end of fiscal 2005. The increase of \$19.9 million was due to new floating-rate debt in the period used to partially finance the acquisition of 7 funeral homes.

Deferred revenue, plus the non-controlling interests in pre-need trust and annuity funds, plus the accumulated benefit of the pre-need funeral group annuity funds excluded from the balance sheet was \$663.8 million at the end of the third quarter of 2006 compared to \$619.1 million at October 31, 2005, an increase of \$44.7 million or 7.2%. Of the \$44.7 million increase, \$20.8 million was related to new operations. The remaining increase of \$23.9 million or 3.9% represented deferral of revenue in the period in excess of amounts recognized upon delivery of merchandise and services.

Future income taxes increased by \$1.0 million due to new future taxes established on the acquisition of 7 funeral homes in the first quarter of \$3.3 million. This increase was partially offset by a reversal of a portion of the future taxes related to the mortgage established on the sale of land in Markham in 2003 and a decrease in future income taxes of \$0.2 million recorded in the third quarter of 2006 due to changes in future tax rates.

CONSOLIDATED STATEMENTS OF CASH FLOWS

THREE MONTHS ENDED JULY 31, 2006

Net cash provided by operating activities of continuing operations in the third quarter of 2006 increased by \$0.2 million from the third quarter of 2005 due to a lower negative net change in other operating balance sheet items of \$0.8 million, partially offset by higher additions to developed land, crypts and niches of \$0.5 million, among other items.

Net cash used for investing activities of continuing operations decreased by \$2.1 million in the third quarter of 2006 compared to the same period of 2005, due mainly to:

- lower additions to fixed assets of \$2.0 million due to lower spending on new initiatives; and
- a smaller increase in pre-need funds in the period of \$2.9 million;
- partially offset by the purchase of a parcel of cemetery land for future development in Calgary, Alberta for \$2.1 million.

New initiative spending in the third quarter of 2005 included \$1.3 million spent on the Mount Lawn Reception Centre in Whitby, Ontario and \$1.0 million spent on the new funeral home in Markham, Ontario. The most spent on any new initiative in the third quarter of 2006 was \$0.2 million.

Net cash provided by financing activities of continuing operations decreased by \$1.3 million over the third quarter of 2005 due to lower increases in non-controlling interests in pre-need funds.

NINE MONTHS ENDED JULY 31, 2006

Net cash provided by operating activities of continuing operations in the first nine months of 2006 increased by \$6.3 million from the same period of 2005 mainly due to:

- a lower negative net change in other operating balance sheet items of \$8.3 million; partially offset by
- higher additions to developed land, crypts and niches of \$1.3 million; and
- lower net earnings of \$0.8 million after adjusting for non-cash items including depreciation and amortization, gain on disposal of assets, provision for asset impairment, future income taxes and developed land, crypt and niche cost of sales.

The lower negative net change in other operating balance sheet items was mostly due to a net decrease in income taxes payable in the first nine months of 2005 of \$3.0 million compared to an increase in income taxes payable in the first nine months of 2006 of \$2.4 million as well as an increase in deferred revenue in the first nine months of 2006 of \$1.2 million compared to a decrease of \$0.2 million in the first nine months of 2005. The net change in income taxes payable was due to a balance owing of \$2.4 million at the end of 2004 that was related to a new subsidiary established in that year and a higher balance owing at July 31, 2006 compared to July 31, 2005 of \$1.6 million due to taxes that became payable in 2006 on the sale of a parcel of land sold subject to a mortgage receivable in 2003.

Net cash used for investing activities of continuing operations increased by \$25.1 million in the first nine months of 2006 mainly due to the acquisition of 7 funeral homes in the first quarter for \$24.0 million and the purchase of a two parcels of cemetery land for future development for \$5.0 million, partially offset by a decrease in additions to fixed assets of \$3.5 million due to lower spending on new initiatives. New initiative spending in the first nine months of 2005 included \$2.4 million spent on the Mount Lawn Reception Centre in Whitby, Ontario, \$2.2 million spent on the new funeral home in Markham, Ontario and \$0.7 million spent to purchase the land and building of an existing funeral home. Comparatively, the large projects in this category in the first nine months of 2006 were \$1.4 million spent on the Mount Lawn Reception Centre in Whitby, Ontario and \$0.6 million spent on the renovation of an existing funeral home in Edmonton, Alberta.

Net cash provided by financing activities of continuing operations increased by \$18.6 million over the first nine months of 2005 due to new debt borrowed to partially finance the acquisition of the 7 funeral homes.

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.

UNAUDITED QUARTERLY RESULTS

	Four Fiscal Quarters Ended July 31, 2006			
	<u>Oct-31/05</u>	<u>Jan-31/06</u>	<u>Apr-30/06</u>	<u>Jul-31/06</u>
Revenue (\$millions)	50.9	50.8	55.9	53.5
Net earnings (\$millions) ⁽¹⁾	4.2	4.4	6.4	4.2
Basic earnings per share (\$) ⁽²⁾	0.38	0.42	0.61	0.39

	Four Fiscal Quarters Ended July 31, 2005			
	<u>Oct-31/04</u>	<u>Jan-31/05</u>	<u>Apr-30/05</u>	<u>Jul-31/05</u>
Revenue (\$millions)	54.2	48.1	51.4	48.6
Net earnings (\$millions) ⁽¹⁾	5.3	4.5	5.7	3.1
Basic earnings per share (\$) ⁽²⁾	0.50	0.43	0.54	0.30

(1) Net earnings from continuing operations do not differ significantly from net earnings.

(2) All earnings per share figures presented are applicable to both Class A and Class B shares. Diluted earnings per share do not differ from basic earnings per share.

Revenue in the second quarter of 2006 increased by \$4.5 million or 8.8% over the same quarter of 2005 due to sales from new funeral operations of \$2.2 million, an increase of \$0.9 million in sales from existing funeral operations and an increase in the delivery of at-need cemetery merchandise and services of \$1.2 million, of which \$0.5 million was related to an administrative project. New operations included seven funeral homes in the Ottawa, Ontario area that were acquired in the first quarter of 2006 and a newly developed funeral home in Markham, Ontario that opened in June of 2005.

Revenue in the second quarter of 2005 was higher than normal due mainly to a 10.4% increase in funeral sales in the quarter, attributable to a 3.3% increase in the number of calls and a 7.1% increase in the average sale per funeral service, as well as the effect of cemetery administrative projects completed in the period that exceeded estimates made in 2004 of \$0.6 million.

Revenue in the fourth quarter of 2004 included an extra week of sales of approximately \$3.4 million and cemetery sales recognized as a result of the effect of administrative projects and one-time accrual adjustments for bronze memorial and upright monument deliveries, which together increased sales by approximately \$2.6 million.

Net earnings and earnings per share in the second quarter of 2006 were higher than the prior six quarters due to the improvement in sales in both the cemetery and funeral divisions and were higher than sales in the third quarter of 2006 due to seasonality.

Net earnings and earnings per share in the second quarter of 2005 were high due to the impact of the 10.4% increase in funeral sales and the cemetery sales recognized as a result of administrative projects.

Net earnings and earnings per share in the fourth quarter of 2004 included the impact of an extra week of operations, administrative projects and accrual adjustments. The estimated impact of these items on net earnings in 2004 was \$1.3 million or \$0.12 per share.

CAPITAL EXPENDITURES AND CEMETERY BURIAL SPACE INVENTORY

Following are projects on which the Company had expended significant funds but that had not generated operating revenue as of July 31, 2006:

Capital Memorial Gardens – mausoleum extension: As at July 31, 2006, the Company had spent \$1.0 million on this project. The Company expects to spend an additional \$0.4 million to complete this project and expects to have the project completed in the fourth quarter of 2006.

Greenlawn Memorial Gardens/Victoria Memorial Gardens – reception centre: As at July 31, 2006, the Company had spent \$0.6 million on this project. The Company estimates that an additional \$6.7 million will be spent to complete this project and anticipates completing the project in fiscal 2007.

In addition, at July 31, 2006, the Company had \$23.7 million in cemetery land held for future development on the balance sheet.

The Company had committed to the following expenditures for capital and cemetery burial space inventory at July 31, 2006 (in \$millions):

Cemetery burial space inventory	1.3
Cemetery maintenance capital expenditures	<u>1.0</u>
	<u>2.3</u>

In addition, the Company had contractually committed to funeral inventory purchases of \$15.5 million, which is to be purchased from February 1, 2006 to July 31, 2008. However, if the Company does not meet its commitment by January 31, 2008, the term of the commitment may be extended.

Following is the Company's expected capital and cemetery burial space inventory spending for the remainder of fiscal 2006 (in \$millions):

Maintenance capital expenditures	4.4
New cemetery and funeral initiatives	0.7
Cemetery burial space inventory	<u>2.0</u>
	<u>7.1</u>

LIQUIDITY AND CAPITAL RESOURCES

The Company anticipates that it can generate sufficient amounts of cash, in the short and the long term, to maintain the Company's capacity and to meet planned growth and development activities. At July 31, 2006, the Company had access to unused operating lines of credit of \$13.0 million (October 31, 2005 – \$12.9 million) and unused floating-rate debt facilities of \$30.8 million (October 31, 2005 – \$50.7 million). The unused floating-rate debt facilities decreased by \$19.9 million from October 31, 2005 due to the new debt established on the acquisition of 7 funeral homes in the first quarter of 2006.

The Company's debt to equity ratio at July 31, 2006 was 0.51:1 (October 31, 2005 – 0.44:1). The increase in the debt to equity ratio from the end of October 2005 was due to the acquisition of 7 funeral homes for \$24.0 million in the first quarter of 2006, which was financed using \$19.9 million in floating-rate bank debt and \$4.1 million in cash.

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. At July 31, 2006 and October 31, 2005, the Company had issued 2,525,497 Class A shares and 8,069,746 Class B shares for \$1.7 million and \$70.8 million respectively.

EVENTS AND UNCERTAINTIES

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

The Funeral and Cremation Services Council of Saskatchewan (“the Council”) has implemented a new levy on pre-need funeral contracts in the province. At this time, the Company is investigating the impact of this measure.

At July 31, 2006, the Ontario Ministry of Government Services (“MGS”) had released five of the anticipated seven regulation segments relating to the Funeral Burial and Cremation Services Act (“FBCSA”). According to the MGS timetable, they intend to circulate a revised draft of the five regulation segments to interested stakeholders and submit amendments to the FBCSA to the legislature later in calendar 2006. While the proclamation date of the legislation remains unknown, the MGS timetable suggests the legislation could be proclaimed in the latter part of calendar 2007 or early in calendar 2008.

August 31, 2006

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS

<i>In \$000</i>	<i>Three Months Ended July 31</i>		<i>Nine Months Ended July 31</i>	
	<i>2006</i>	<i>2005 ⁽¹⁾</i>	<i>2006</i>	<i>2005 ⁽¹⁾</i>
Revenue				
Sales	49,602	45,093	149,041	137,338
Investment and other income	3,908	3,548	11,167	10,883
	53,510	48,641	160,208	148,221
Expenses				
Operating	42,950	39,320	124,057	115,330
Corporate	3,386	3,722	10,415	10,024
	46,336	43,042	134,472	125,354
Earnings before interest expense and income taxes	7,174	5,599	25,736	22,867
Interest expense	1,300	988	3,768	3,048
Earnings before income taxes	5,874	4,611	21,968	19,819
Income taxes (note 9)	1,695	1,505	7,033	6,522
Net earnings from continuing operations	4,179	3,106	14,935	13,297
Net (loss) earnings from discontinued operation (note 10)	(10)	25	76	63
Net earnings	4,169	3,131	15,011	13,360
Weighted average number of shares outstanding (in thousands)	10,595	10,595	10,595	10,595
Earnings per share - basic and fully diluted (in \$)				
Earnings per share from continuing operations	0.39	0.30	1.41	1.25
Earnings per share from discontinued operations	-	-	0.01	0.01
Earnings per share - basic and fully diluted (in \$)	0.39	0.30	1.42	1.26

⁽¹⁾ Restated - see note 10.

UNAUDITED CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

	<i>Three Months Ended July 31</i>		<i>Nine Months Ended July 31</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>(\$000)</i>		<i>(\$000)</i>	
Retained earnings, beginning of period	111,304	93,908	100,462	83,679
Net earnings for the period	4,169	3,131	15,011	13,360
Retained earnings, end of period	115,473	97,039	115,473	97,039

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED BALANCE SHEETS

<i>In \$000</i>	<i>July 31</i> <i>2006</i>	<i>As at</i> <i>October 31</i> <i>2005⁽¹⁾</i>
Assets		
Current assets		
Cash	8,032	10,954
Accounts receivable	17,914	17,770
Merchandise inventories	9,598	9,437
Prepaid expenses	751	450
Assets related to discontinued operation, current portion (note 10)	123	116
Pre-need receivables, current portion	39,272	38,214
	75,690	76,941
Pre-need receivables and funds	440,961	413,445
Cemetery care funds	153,058	145,105
Crypts and niches	24,444	26,247
Cemetery land	35,923	31,339
Fixed assets	182,915	167,351
Goodwill	55,120	44,336
Mortgage receivable	13,500	13,669
Deferred obtaining costs and stored merchandise	71,506	68,763
Assets related to discontinued operation (note 10)	3,637	3,704
Intangible and other assets (note 5)	2,931	758
	1,059,685	991,658
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	20,948	27,117
Income taxes payable	2,841	721
Long-term debt, current portion	1,426	2,443
	25,215	30,281
Deferred revenue (note 7)	176,696	174,975
Non-controlling interests in pre-need funds	403,529	377,237
Long-term debt	94,669	73,720
Future income taxes (note 9)	4,746	3,757
Liabilities related to discontinued operation (note 10)	2,899	2,948
Other liabilities	10,901	10,674
	718,655	673,592
Non-controlling interests in cemetery care funds	153,058	145,105
Shareholders' equity		
Share capital (note 8)	72,499	72,499
Retained earnings	115,473	100,462
	187,972	172,961
	1,059,685	991,658

⁽¹⁾ Certain figures provided for October 31, 2005 have been reclassified to conform with the current period's presentation.

Arbor Memorial Services Inc.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>In \$000</i>	<i>Three Months Ended</i>		<i>Nine Months Ended</i>	
	<i>July 31</i>		<i>July 31</i>	
	<i>2006</i>	<i>2005 ⁽¹⁾</i>	<i>2006</i>	<i>2005 ⁽¹⁾</i>
Cash provided by (used for)				
Operating activities				
Net earnings	4,169	3,131	15,011	13,360
Add (deduct) net earnings from discontinued operations (note 10)	10	(25)	(76)	(63)
Add (deduct) items not affecting cash from operating activities:				
Depreciation and amortization	2,493	2,283	7,372	6,409
Gain on disposal of assets	(60)	(71)	(188)	(155)
Provision for asset impairment	-	-	-	30
Future income taxes (note 9)	(816)	399	(2,152)	699
Developed land, crypt and niche cost of sales	1,982	2,105	6,214	6,669
Additions to developed land, crypts and niches	(1,027)	(499)	(4,024)	(2,693)
Net change in other operating balance sheet items (note 12)	(1,480)	(2,238)	(6,549)	(14,898)
Net cash provided by continuing operations	5,271	5,085	15,608	9,358
Net cash provided by discontinued operations	10	15	88	75
Investing activities				
Additions to fixed assets	(2,907)	(4,912)	(8,350)	(11,836)
Acquisition (note 2)	-	-	(23,997)	-
Additions to cemetery land held for future development	(2,122)	-	(4,971)	(17)
Proceeds on disposal of assets	61	465	192	695
Change in pre-need funds	(2,417)	(5,358)	(9,550)	(10,980)
Change in cemetery care funds	(2,737)	(2,443)	(7,953)	(7,379)
Net cash used for continuing operations	(10,122)	(12,248)	(54,629)	(29,517)
Net cash provided by discontinued operations	21	20	46	1,319
Financing activities				
Proceeds from new long-term debt (note 2)	-	-	19,942	-
Repayment of long-term debt	(3)	(170)	(10)	(177)
Dividends	-	-	(742)	(742)
Change in non-controlling interests in pre-need funds	3,605	5,335	8,869	10,922
Change in non-controlling interests in cemetery care funds	2,737	2,443	7,953	7,379
Net cash provided by continuing operations	6,339	7,608	36,012	17,382
Net cash provided by (used for) discontinued operations	(20)	6	(47)	(47)
Increase (decrease) in cash	1,499	486	(2,922)	(1,430)
Cash, beginning of period	6,533	8,485	10,954	10,401
Cash, end of period	8,032	8,971	8,032	8,971
Supplementary information				
Income taxes paid	2,111	1,779	7,543	9,243
Interest paid	1,297	994	3,767	3,087

⁽¹⁾ Restated - see note 9.

ARBOR MEMORIAL SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Nine Months Ended July 31, 2006 and 2005

1. BASIS OF PREPARATION

The accompanying unaudited quarterly 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 2005 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 2005 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.

Under CICA Handbook Section 1581 Business Combinations, intangible assets are recognized apart from goodwill when the assets result from contractual or other legal rights or the assets are capable of being separated or divided from the acquired enterprise and sold, transferred, licensed, rented or exchanged. In the purchase price allocation of the acquisition described in note 2, the Company recognized a future benefit related to the pre-need funeral contracts acquired and the value of the trade name. The future benefit related to the pre-need funeral contracts represented deferred obtaining costs that the Company did not have to incur to obtain the pre-need contracts. This benefit is being expensed based on estimated timing of contract delivery. The value of the trade name acquired was calculated using the Capitalized Royalty Income Method, whereby the trade name was valued by reference to the amount of royalty income it could generate if it was licensed, in an arm's-length transaction, to a third party. The value of the trade name is not subject to amortization as the trade name has an indefinite life.

The value of the future benefit related to the pre-need funeral contracts acquired will be tested for impairment by comparing the carrying value of the benefit, and other long-lived assets related to the acquisition, to the future undiscounted cash flows whenever impairment indicators arise. If the carrying value is greater than the undiscounted future cash flows, a fair value is calculated and any shortfall in the fair value compared to net book value is recorded as a provision for impairment of assets. The value of the trade name will be reviewed annually by comparing the carrying value and the fair value, or more frequently if impairment indicators arise, to determine if an impairment loss should be recognized. An impairment charge will be recorded if the value of the trade name is considered impaired.

2. ACQUISITION

On November 8, 2005, the Company acquired a group of 7 funeral homes for \$23.5 million in cash consideration and \$0.5 million in closing costs. The Company financed the acquisition with \$19.9 million in floating-rate bank debt under the Company's existing revolving term facilities and \$4.1 million in cash. The acquisition was accounted for using the purchase method under which the results of the operations since the date of acquisition are included in these financial statements. Details of the purchase allocation follow (in \$000):

Assets acquired:	
Accounts receivable	804
Merchandise inventories	208
Other assets	69
Income taxes recoverable	257
Pre-need receivables and funds	17,979
Fixed assets	14,545
Intangible asset subject to amortization	953
Intangible asset not subject to amortization	<u>1,145</u>
	<u>35,960</u>

Liabilities assumed:	
Accounts payable and accrued liabilities	1,474
Deferred revenue	556
Non-controlling interests in pre-need funds	17,423
Future income taxes	<u>3,294</u>
	<u>22,747</u>
Net assets acquired	13,213
Goodwill arising on acquisition	<u>10,784</u>
Total consideration	<u><u>23,997</u></u>

3. PRE-NEED FUNERAL GROUP ANNUITY FUNDS

The consolidated balance sheets do not include pre-need funeral 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 July 31, 2006, the accumulated benefit of all such contracts was \$83.6 million (October 31, 2005 - \$67.0 million).

4. MORTGAGE RECEIVABLE

During the year, the term of the mortgage receivable was extended from April 30, 2007 to January 30, 2008. One-half of the mortgage receivable is due on April 30, 2007 and the remainder is due on January 30, 2008. A lump sum interest payment of \$0.8 million was made effective January 31, 2006 and a second interest payment of \$0.5 million is scheduled to be made on January 31, 2007. The payments represent interest rates of 6.0% and 6.5% respectively calculated on the blended principal amount of the mortgage.

5. INTANGIBLE AND OTHER ASSETS

	<u>July 31</u>	<u>October 31</u>
	<u>2006</u>	<u>2005</u>
	(\$000)	
Intangible asset subject to amortization	908	-
Intangible asset not subject to amortization	1,145	-
Other assets	<u>878</u>	<u>758</u>
	<u><u>2,931</u></u>	<u><u>758</u></u>

The intangible asset subject to amortization at July 31, 2006 represented a future benefit related to the pre-need funeral contracts acquired as described in note 2. The intangible asset not subject to amortization represented the value of the trade name acquired in the acquisition described in note 2. The Company amortized less than \$0.1 million of the intangible asset subject to amortization in the nine months ended July 31, 2006 (first nine months of 2005 – \$nil).

6. DERIVATIVE FINANCIAL INSTRUMENTS

As of July 31, 2006, the Company's use of derivative financial instruments was limited to seven (October 31, 2005 – seven) interest rate swap agreements with a Canadian chartered bank. Total debt under swap contracts at the end of the period was \$44.5 million (October 31, 2005 - \$48.4 million) and the estimated fair value of the interest rate swaps was a loss of \$0.5 million (October 31, 2005 – loss of \$1.6 million). Total swaps and other fixed rate debt represented 48% (October 31, 2005 – 66%) of the total amount of long-term debt outstanding. Swap costs for the third quarter and the first nine months of 2006 were \$0.2 million and \$0.6 million respectively (2005 - \$0.3 million and \$1.1 million respectively).

7. DEFERRED REVENUE

Sales that have not yet been recognized in revenue, and which remain uncollected from customers, are presented under deferred revenue. Upon collection, a portion of these instalment accounts receivable are required to be deposited directly to legislated trust funds. Once the Company deposits these amounts to legislated trust funds, the corresponding deferred revenue will be reclassified to non-controlling interests in pre-need funds. At July 31, 2006, \$38.1 million (October 31, 2005 – \$35.9 million) of deferred revenue related

to instalment accounts receivable that will be deposited to legislated trust funds upon collection, representing 56% (October 31, 2005 – 53%) of the total outstanding instalment accounts receivable.

8. SHARE CAPITAL

Issued and outstanding

	<u>July 31</u> <u>2006</u>	<u>October 31</u> <u>2005</u>
	(000)	
Number of Class A Voting Shares	2,525	2,525
Number of Class B Non-Voting Shares	8,070	8,070
	<u>10,595</u>	<u>10,595</u>

9. INCOME TAXES

Income tax expense

Income tax expense for the three and nine months ended July 31 consisted of the following:

	<u>Three Months Ended</u> <u>July 31</u>		<u>Nine Months Ended</u> <u>July 31</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
	(\$000)		(\$000)	
Current tax expense	2,510	1,106	9,185	5,823
Future income tax expense	(579)	399	(1,916)	699
Future income tax benefit arising from change in tax rates	(236)	-	(236)	-
	<u>1,695</u>	<u>1,505</u>	<u>7,033</u>	<u>6,522</u>

Effective income tax rate

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

	<u>Three Months Ended</u> <u>July 31</u>		<u>Nine Months Ended</u> <u>July 31</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
	%		%	
Combined basic federal and provincial income tax rate	33.3	31.3	34.0	33.5
Increase (decrease) in the basic tax rate resulting from:				
Change in tax rates for future tax expense	(4.0)	-	(1.1)	-
Large corporations tax	0.1	1.3	0.1	0.9
Dividends/RDTH	(1.1)	(1.3)	(0.9)	(0.9)
Non-taxable portion of capital gains and losses	0.2	0.8	(0.5)	(0.3)
Meals and entertainment	0.4	0.4	0.3	0.3
Recovery of prior year over-provision	-	-	(0.2)	(0.7)
Other changes	-	0.1	0.3	0.1
Effective income tax rate	<u>28.9</u>	<u>32.6</u>	<u>32.0</u>	<u>32.9</u>

Net future income tax liability

The net future income tax liability is comprised of:

	<u>July 31, 2006</u>		<u>October 31, 2005</u>	
	<u>Temporary</u> <u>Difference</u>	<u>Tax</u> <u>Effect</u>	<u>Temporary</u> <u>Difference</u>	<u>Tax</u> <u>Effect</u>
	(\$000)		(\$000)	
Future income tax assets:				
Deferred revenue	55,786	19,213	56,571	20,275
Cancellation/chargeback provisions	8,497	2,926	7,087	2,540

Deferred losses on pre-need contracts	1,008	347	1,214	435
Other	2,756	949	2,638	945
	<u>68,047</u>	<u>23,435</u>	67,510	24,195

Future income tax liabilities:

Reserves claimed for future delivery of cemetery land and merchandise	(41,330)	(14,234)	(49,494)	(17,739)
Excess of share acquisition costs over book value	(19,064)	(6,566)	(11,059)	(3,964)
Deferred expenses	(11,053)	(3,807)	(10,765)	(3,858)
Excess of net book value over tax value of capital assets	(6,032)	(2,077)	(4,283)	(1,535)
Intangible assets	(2,053)	(707)	-	-
Pre-need trust income	(1,265)	(436)	(1,353)	(485)
Other	(1,031)	(354)	(1,036)	(371)
	<u>(81,828)</u>	<u>(28,181)</u>	(77,990)	(27,952)
	<u>(13,781)</u>	<u>(4,746)</u>	(10,480)	(3,757)

10. DISCONTINUED OPERATIONS

In 2004, the assets of one funeral branch operation met the criteria for being classified as a discontinued operation according to the provisions of CICA Handbook Section 3475 "Disposal of Long-Lived Assets and Discontinued Operations". The sale of this operation was completed in the second quarter of 2005. In the fourth quarter of 2005, the assets of a second funeral branch operation met the criteria for being classified as a discontinued operation. The sale of this operation occurred in the fourth quarter of 2006.

Revenue associated with discontinued operations was \$0.1 million and \$0.4 million respectively for the three and nine months ended July 31, 2006 (2005 – \$0.1 million and \$0.6 million respectively). Net earnings for the three and nine months ended July 31, 2006 were less than \$0.1 million and \$0.1 million respectively (2005 – less than \$0.1 million and \$0.1 million). The comparative amounts for the first nine months of 2005 have been reclassified for the funeral branch identified as a discontinued operation in the fourth quarter of 2005.

11. CONTRACTUAL COMMITMENTS

At July 31, 2006, the Company was contractually committed to capital and cemetery burial space inventory expenditures of \$2.3 million. The Company expects that all of these commitments will be spent within one year from July 31, 2006. In addition, the Company was contractually committed to funeral inventory purchases of \$15.5 million, which is to be purchased from February 1, 2006 to January 31, 2008. However, if the Company does not meet its commitment by January 31, 2008, the term of the commitment may be extended.

12. NET CHANGE IN OTHER OPERATING BALANCE SHEET ITEMS

	<i>Three Months</i>		<i>Nine Months</i>	
	<i>Ended July 31</i>		<i>Ended July 31</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>(\$000)</i>		<i>(\$000)</i>	
Accounts receivable	532	126	660	(468)
Merchandise inventories	104	(403)	47	(579)
Prepaid expenses	180	328	(301)	(318)
Pre-need receivables	(602)	12	(1,045)	350
Deferred obtaining costs and stored merchandise	(1,284)	(546)	(2,743)	(2,324)
Accounts payable and accrued liabilities	(1,463)	(690)	(6,901)	(7,873)
Income taxes payable	704	(265)	2,377	(3,045)
Deferred revenue	451	(800)	1,165	(205)
Other	(102)	-	192	(436)
	<u>(1,480)</u>	<u>(2,238)</u>	<u>(6,549)</u>	<u>(14,898)</u>

13. SUBSEQUENT EVENT

Subsequent to July 31, 2006, the Company sold one funeral branch operation for cash consideration of \$0.9 million. The cash consideration was approximately equal to the book value of the assets.

14. SEGMENT DISCLOSURE

Industry segments (\$000)

	Three Months Ended July 31							
	Cemetery		Funeral		Corporate		Consolidated	
	2006	2005	2006	2005	2006	2005	2006	2005
	(3)							
Sales ⁽¹⁾	24,345	23,266	25,106	21,688	151	139	49,602	45,093
Investment and other income ⁽¹⁾	2,372	2,306	1,306	1,060	230	182	3,908	3,548
Revenue ⁽¹⁾	26,717	25,572	26,412	22,748	381	321	53,510	48,641
Depreciation and amortization ⁽¹⁾	(810)	(737)	(1,309)	(1,122)	(374)	(424)	(2,493)	(2,283)
Earnings before interest expense and income taxes ⁽¹⁾	3,369	3,281	6,810	5,719	(3,005)	(3,401)	7,174	5,599
Interest expense	-	-	-	-	(1,300)	(988)	(1,300)	(988)
Earnings before income taxes ⁽¹⁾	3,369	3,281	6,810	5,719	(4,305)	(4,389)	5,874	4,611
Capital expenditures ⁽¹⁾	1,508	2,236	1,145	2,119	254	557	2,907	4,912
Developed land, crypt and niche additions	1,027	499	-	-	-	-	1,027	499
Cemetery land held for future development additions	2,122	-	-	-	-	-	2,122	-
Pre-need contracts written	18,241	17,320	13,386	10,624	-	-	31,627	27,944
	Nine Months Ended July 31							
	Cemetery		Funeral		Corporate		Consolidated	
	2006	2005	2006	2005	2006	2005	2006	2005
	(3)							
Sales ⁽¹⁾	69,257	66,375	79,336	70,532	448	431	149,041	137,338
Investment and other income ⁽¹⁾	7,043	6,924	3,495	3,422	629	537	11,167	10,883
Revenue ⁽¹⁾	76,300	73,299	82,831	73,954	1,077	968	160,208	148,221
Depreciation and amortization ⁽¹⁾	(2,381)	(2,215)	(3,879)	(3,457)	(1,112)	(737)	(7,372)	(6,409)
Earnings before interest expense and income taxes ⁽¹⁾	11,012	9,870	24,062	22,053	(9,338)	(9,056)	25,736	22,867
Interest expense	-	-	-	-	(3,768)	(3,048)	(3,768)	(3,048)
Earnings before income taxes ⁽¹⁾	11,012	9,870	24,062	22,053	(13,106)	(12,104)	21,968	19,819
Identifiable assets ⁽²⁾	566,168	541,976	466,945	420,421	26,572	29,261	1,059,685	991,658
Capital expenditures ⁽¹⁾	4,784	4,480	3,131	5,833	435	1,523	8,350	11,836
Developed land, crypt and niche additions	4,024	2,693	-	-	-	-	4,024	2,693
Cemetery land held for future development additions	4,971	17	-	-	-	-	4,971	17
Pre-need contracts written	51,879	50,532	38,067	33,325	-	-	89,946	83,857

(1) Figures provided for 2005 have been restated to conform with the current year's presentation. See note 9.

(2) Identifiable assets shown for 2005 are as at October 31.

(3) The "Corporate" balances are provided principally to reconcile the reportable segments to consolidated results.