

Second Quarter Report

**Six Months Ended
April 30, 2006**



**ARBOR
MEMORIAL
SERVICES INC.**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis has been prepared for the six months ended April 30, 2006 and includes material information available up to May 30, 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 Second 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 Second 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, 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 APRIL 30, 2006 COMPARED TO THE THREE MONTHS ENDED APRIL 30, 2005

TOTAL COMPANY RESULTS

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

	<u>2006</u>		<u>2005</u>	
	<u>\$Millions</u>	<u>% of Total</u>	<u>\$Millions</u>	<u>% of Total</u>
Sales				
Cemetery	23.9	42.7	22.5	43.8
Funeral	28.1	50.3	25.0	48.6
Corporate	0.1	0.2	0.1	0.2
	<u>52.1</u>	<u>93.2</u>	<u>47.6</u>	<u>92.6</u>
Investment and other income	3.8	6.8	3.8	7.4
	<u>55.9</u>	<u>100.0</u>	<u>51.4</u>	<u>100.0</u>

Revenue for the quarter ended April 30, 2006 increased by 8.6% to \$55.9 million. All of the increase was in sales, while investment and other income decreased marginally to \$3.8 million.

Sales in the cemetery division increased by \$1.4 million or 6.2%, while sales in the funeral division increased by \$3.1 million or 12.2%. Of the \$3.1 million increase in the funeral division, \$2.2 million was related to new operations. Sales from existing operations in the funeral division increased by 3.6%, which resulted from an increase in calls of 1.0% and an increase in the average sale per call of 2.6%.

Investment and other income in the second quarter of 2006 decreased by 1.0% to \$3.8 million due to a reduction in the fees received under the pre-need funeral annuity and the pre-need funeral and cemetery trust programs. Income earned on the cemetery care funds increased by 2.0%.

Operating expenses increased by \$2.5 million or 6.5% to \$41.5 million in the second quarter of 2006 compared to the same period in 2005. Cemetery division expenses increased by \$0.7 million or 3.2% due mainly to an increase in cost of sales expense. Funeral division expenses increased by \$1.9 million or 10.5%, which was mostly related to new operations.

Corporate expenses increased by \$0.4 million or 13.8% to \$3.5 million, which was due to an increase in employee costs, including bonus accruals, and an increase in depreciation expense as a result of the implementation of a new operating system in 2005.

Earnings before interest expense and income taxes were \$10.8 million, which represented an increase of \$1.4 million or 15.4% compared to 2005. The increase was attributable to an improvement in earnings of the cemetery division of \$0.7 million or 19.2% and an improvement in earnings of the funeral division of \$1.1 million or 13.1%. Both of these earnings improvements were due to higher sales in the quarter. Partially offsetting these improvements was an increase in the net loss of 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 \$0.2 million or 23.2% to \$1.3 million in the second 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 increased by \$18.6 million or 24.1%.

With respect to swap costs, since actual floating interest rates before bank margins averaged 4.5% (2005 – 3.5%) during the quarter, the swaps caused the Company's interest expense to be higher in 2006 by \$0.2 million (2005 - \$0.4 million) than would otherwise have been the case if the Company had maintained all floating-rate debt. The weighted average rate of interest on long-term debt for the quarter was 5.3% compared to 5.4% 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 proportion of fixed-rate debt at April 30, 2006, including swap contracts, was 50% compared to 66% at October 31, 2005.

Income taxes for the second quarter of 2006 resulted in an effective tax rate of 33.4%, compared to 32.0% in the second quarter of 2005. The 1.4% increase in the rate was due to a dividend refund in the second quarter of 2005 and a lower recovery of a prior year over-provision in the second quarter of 2006 compared to the same quarter of 2005. However, these items were partially offset by a lower large corporations tax in 2006 due to a higher surtax paid and a reduction in the rate. The combined basic federal and provincial income tax rate was higher in 2006 compared to 2005 by 0.3 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 second quarter of 2006 were \$6.4 million and \$0.61 respectively compared to \$5.7 million and \$0.54 per share in 2005. The increase of \$0.7 million or 12.6% was attributable to improved earnings in the cemetery and funeral divisions as a result of higher sales.

CEMETERY DIVISION

Cemetery sales in the second quarter of 2006 increased by \$1.4 million or 6.2% over the second quarter of 2005 to \$23.9 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;
- \$6.9 million (2005 - \$6.7 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;
- \$8.6 million (2005 - \$7.4 million) of at-need sales of interment rights and deliveries of at-need merchandise and services.

Following is a breakdown of the \$1.4 million increase in total cemetery sales (in \$millions):

<u>At-Need</u>	
Interment rights	-
Merchandise	0.9
Services	<u>0.3</u>
	<u>1.2</u>
<u>Pre-Need</u>	
Interment rights	-
Merchandise	0.1
Services	<u>0.1</u>
	<u>0.2</u>
	<u>1.4</u>

Of the \$0.9 million increase in the delivery of at-need merchandise, \$0.4 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 compared to a \$0.1 million reduction in sales in 2005 from a similar administrative project;
- 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 the first and second quarters of 2006; and
- higher deliveries of contracts written in the second quarter of 2006 compared to the second quarter of 2005.

Of the remaining increase in deliveries of at-need merchandise of \$0.5 million and the \$0.3 million increase in deliveries of at-need services, \$0.4 million occurred as a result of administrative projects that identified merchandise and services delivered in prior years. The impact of administrative projects on net earnings in the period was \$0.2 million.

Pre-need cemetery sales contracts written in the quarter were \$18.2 million, compared to \$18.0 million in 2005. This represented an increase of \$0.2 million or 1.2%. 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 second quarter of 2006, the number of interments performed by the Company decreased by 1.7% to 4,082 and the number of cremations decreased by 1.8% to 3,695. This compared to increases in interments in each of

fiscal 2005 and 2004 of 0.2% and 2.4% respectively and increases in cremations of 0.2% 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, remained consistent at \$2.3 million. Interest and dividend income earned on the cemetery care funds increased by 2.0% over the second quarter of 2005 to \$1.9 million due to an increase in the average balance outstanding and despite a reduction in the average rate of return of 0.2 of a percentage point. Fees received from the deposit of pre-need cemetery funds decreased by 8.7% 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 4.9% due to a higher average balance in the funds of \$14.2 million or 8.7%. The impact of the higher balance was partially offset by a lower annualized average rate of return on the funds from 4.3% in 2005 to 4.1% 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 quarter increased by \$0.7 million or 3.2% as follows (in millions):

Cost of sales	0.4
Selling	0.1
Other	<u>0.2</u>
	<u>0.7</u>

The increase in cost of sales expense of \$0.4 million was due to the increase in sales. The cost of sales percentage for the quarter decreased from 47.1% in 2005 to 46.2% in 2006 mainly due to an increase in the sale of at-need services of \$0.3 million or 16.6%, which carry a lower cost of sales percentage.

Earnings before interest expense and income taxes in the cemetery division increased by \$0.7 million or 19.2% in the second quarter of 2006 compared to 2005 due mainly to the increase in sales.

FUNERAL DIVISION

Funeral sales in the second quarter of 2006 increased by \$3.1 million or 12.2% over the second quarter of 2005 to \$28.1 million. The improvement was attributable to a \$2.2 million increase in sales from new operations and a \$0.9 million or 3.6% 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 and a new funeral home in Markham, Ontario that opened in June 2005. The 3.6% increase in sales from existing operations was due to a 2.6% increase in the average sale per funeral service and a 1.0% increase in the number of calls.

Sales from existing operations in the quarter consisted of \$17.1 million (2005 - \$17.2 million) of at-need sales of funeral merchandise and services and \$8.8 million (2005 - \$7.7 million) from the fulfilment of merchandise and services sales that were arranged on a pre-need basis. Pre-need funeral contracts written in the quarter totalled \$14.2 million compared to \$12.8 million in the second quarter of 2005, an increase of \$1.4 million or 11.2%. The increase was primarily related to the new funeral homes acquired in the Ottawa, Ontario area.

Investment and other income in the funeral division decreased by \$0.1 million or 5.9% to \$1.2 million in the second quarter of 2006. The reduction was attributable to a decrease in the fees received from the deposit of pre-need funeral funds under the group annuity program of 3.8% and a decrease in the fees received under the trust program of 11.0%. The decrease in fees received under the 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 reinvestment of a portion of the funds at lower rates.

Funeral expenses in the second quarter of 2006 increased by \$1.9 million or 10.5%, which was mainly related to new operations. A breakdown of the \$1.9 million increase by type of expenditure follows (in \$millions):

Cost of sales	0.6
Services	1.1
Facilities	0.1
Motor equipment	<u>0.1</u>
	<u>1.9</u>

The increase in the cost of sales expense was related to the increase in sales and a change in the mix of sales. The cost of sales percentage increased by 0.4 of a percentage point. Of the \$1.1 million increase in services expense, \$1.0 million was incurred by new operations. Service expenses of existing operations increased by \$0.1 million or 1.2% in the period due mainly to increased employee costs.

Earnings before interest expense and income taxes in the funeral division increased by \$1.1 million or 13.1%, to \$9.5 million in the second quarter of 2006. Of the \$1.1 million increase, \$0.4 million was due to new operations. Excluding new operations, earnings improved by 8.5% due to the 3.6% increase in sales and consistent expenses compared to 2005.

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 second quarter of 2006 compared to \$0.3 million in the second quarter of 2005.

Corporate expenses increased by \$0.4 million or 13.8%, to \$3.5 million in the second quarter of 2006 due mainly to an increase in depreciation as a result of the implementation of the Company's new operating system, an increase in bonus accruals based on the second quarter results and an increase in employee costs including benefits. As a percentage of total Company revenue, corporate expenses for the second quarter of 2006 increased to 6.4% from 6.1% in the second quarter of 2005.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED APRIL 30, 2006 COMPARED TO THE SIX MONTHS ENDED APRIL 30, 2005

TOTAL COMPANY RESULTS

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

	<u>2006</u>		<u>2005</u>	
	<u>\$Millions</u>	<u>% of Total</u>	<u>\$Millions</u>	<u>% of Total</u>
Sales				
Cemetery	44.9	42.1	43.1	43.3
Funeral	54.2	50.8	48.9	49.1
Corporate	0.3	0.3	0.3	0.3
	<u>99.4</u>	<u>93.2</u>	<u>92.3</u>	<u>92.7</u>
Investment and other income	7.3	6.8	7.3	7.3
	<u>106.7</u>	<u>100.0</u>	<u>99.6</u>	<u>100.0</u>

Revenue for the six months ended April 30, 2006 was \$106.7 million. This represented a \$7.1 million or 7.1% increase over the first six months of 2005.

Sales in the cemetery division increased by \$1.8 million or 4.2%, while sales in the funeral division increased by \$5.4 million or 11.0%. Of the \$5.4 million increase in the funeral division, \$4.4 million was related to new operations. Sales from existing operations in the funeral division increased by 2.1%, which was the net impact of an increase of 2.7% in the average sale per funeral service and a decrease of 0.6% in the number of services. The cemetery division experienced a decrease in the number of interments of 3.1%.

Investment and other income in the first six months of 2006 decreased by \$0.1 million or 1.0% due to a reduction in the fees received under the pre-need funeral annuity and trust programs of 7.3% and a reduction in the fees received under the cemetery trust program of 1.9%. Income earned on the cemetery care funds increased by \$0.1 million or 1.8%.

Operating expenses increased by \$5.1 million or 6.7% to \$81.1 million in the first six months of 2006 compared to the same period in 2005. Cemetery division expenses increased by \$0.8 million or 1.9% due mainly to increases in selling and care and maintenance expenses. Funeral division expenses increased by \$4.3 million or 12.3%, of which \$3.6 million was related to new operations. Excluding new operations, funeral division expenses increased by \$0.7 million or 1.9%.

Corporate expenses increased by \$0.7 million or 11.5% to \$7.0 million, of which \$0.4 million was due to an increase in depreciation expense as a result of the implementation of a new operating system in 2005 and \$0.4

million was due to an increase in employee costs. The increases in these expenses were partially offset by decreases in other corporate expenses.

Earnings before interest expense and income taxes for the first six months of 2006 were \$18.6 million, which represented an increase of \$1.3 million or 7.5% compared to the same period of 2005. The \$1.3 million increase was due to a \$1.1 million improvement in cemetery operations and a \$0.9 million improvement in funeral operations. These improvements were partially offset by an increase in the loss from corporate operations.

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 \$0.4 million or 19.8% to \$2.5 million in the first six 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 \$19.1 million or 24.7%.

With respect to swap costs, since actual floating interest rates before bank margins averaged 4.2% (2005 – 3.4%) in the period, the swaps caused the Company's interest expense to be higher in 2006 by \$0.4 million (2005 - \$0.7 million) than would otherwise have been the case if the Company had maintained all floating-rate debt. The weighted average rate of interest on long-term debt for the period was 5.1% 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 proportion of fixed-rate debt at April 30, 2006, including swap contracts, was 50% compared to 66% at October 31, 2005.

Income taxes for the first six months of 2006 resulted in an effective tax rate of 33.2%, compared to 33.0% in the first six months of 2005. The 0.2% increase in the rate was due to a lower recovery of a prior year over-provision in 2006 compared to 2005. However, the impact of this recovery was partially offset by a lower large corporations tax in 2006 due to a higher surtax paid and a reduction in the rate. The combined basic federal and provincial income tax rate was higher in 2006 compared to 2005 by 0.2 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 six months of 2006 were \$10.8 million and \$1.02 per share respectively compared to \$10.2 million and \$0.97 per share in the same period of 2005. The increase of \$0.6 million or 6.0% was attributable to an improvement in operating earnings of the cemetery and funeral divisions.

CEMETERY DIVISION

Cemetery sales in the first six months of 2006 increased by \$1.8 million or 4.2% over the first six months of 2005 to \$44.9 million. Sales, including finance charges and net of cancellation allowances, consisted of:

- \$15.6 million (2005 – \$15.7 million) of pre-need sales of interment rights;
- \$13.3 million (2005 – \$12.3 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;
- \$16.0 million (2005 – \$15.1 million) of at-need sales of interment rights and deliveries of at-need merchandise and services.

Following is a breakdown of the \$1.8 million increase in total cemetery sales (in \$millions):

<u>At-Need</u>	
Interment rights	(0.2)
Merchandise	0.7
Services	<u>0.4</u>
	<u>0.9</u>
<u>Pre-Need</u>	
Interment rights	(0.1)
Merchandise	0.9
Services	<u>0.1</u>
	<u>0.9</u>
	<u><u>1.8</u></u>

Of the \$0.7 million increase in the delivery of at-need merchandise, \$0.5 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 compared to a \$0.1 million reduction in sales in 2005 from a similar administrative project;

- 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 the first and second quarters of 2006; and
- higher deliveries of contracts written in the second quarter of 2006 compared to the second quarter of 2005.

Of the remaining increase in deliveries of at-need merchandise of \$0.2 million and the \$0.4 million increase in deliveries of at-need services, \$0.4 million occurred as a result of administrative projects that identified merchandise and services delivered in prior years. The impact of administrative projects in the period on net earnings was \$0.2 million.

Of the \$0.9 million increase in pre-need merchandise sales, \$0.8 million was due to an increase in the delivery of upright monuments. More than half of 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 six months of 2006 over the same period of 2005 by \$0.5 million or 27.6% and contracts written in fiscal 2005 increased over 2004 by 5.7%.

Pre-need cemetery sales contracts written in the first six months of 2006 were \$33.6 million, compared to \$33.2 million in 2005. This represented an increase of \$0.4 million or 1.3%. 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 first six months of 2006, the number of interments performed by the Company decreased by 3.1% to 7,992 and the number of cremations increased by 0.8% to 7,368. This compared to increases in interments in each of fiscal 2005 and 2004 of 0.2% and 2.4% respectively and increases in cremations of 0.2% and 1.7% respectively on a comparable basis.

Cemetery investment income increased by \$0.1 million or 1.1% over the first six months of 2005 to \$4.7 million due to an increase in care fund income. Interest and dividend income earned on the care funds increased by 2.0% due to a higher average balance in the funds of \$10.7 million or 7.8% and despite a decrease in the annualized average rate of return on the funds from 5.6% in the first six 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 \$0.2 million or 5.7% due to a higher average balance in the funds of \$14.3 million or 8.8%. The impact of the higher balance was partially offset by 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 six months of 2006 increased by \$0.8 million or 1.9% as follows (in millions):

Cost of sales	-
Selling	0.4
Care and maintenance	0.2
Other	<u>0.2</u>
	<u>0.8</u>

Cost of sales expense was consistent with 2005 despite a \$1.8 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 \$0.2 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 \$0.4 million or 11.4% 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 46.9% compared to 47.6% in the first six months of 2005.

The \$0.4 million or 4.7% increase in selling expenses was due to higher employee costs and managerial commissions as well as a new marketing campaign utilizing billboards, among other items. The \$0.2 million or 2.9% increase in care and maintenance expenses was driven by higher employee costs.

Earnings before interest expense and income taxes in the cemetery division increased by \$1.1 million or 16.0% in the first six months of 2006 compared to 2005 due mainly to the increase in sales and the consistent cost of sales expense.

FUNERAL DIVISION

Funeral sales in the first six months of 2006 increased by \$5.4 million or 11.0% over the first six months of 2005 to \$54.2 million. The improvement was attributable to a \$4.4 million increase in sales from new operations and a \$1.0 million or 2.1% 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 and a new funeral home in Markham, Ontario that opened in June 2005. The 2.1% increase in sales from existing operations was due to a 2.7% improvement in the average sale per funeral service. A decrease in existing home calls of 0.6% compared to 2005 partially offset the impact of the increase in the average sale per funeral service.

Sales from existing operations in the period consisted of \$33.3 million (2005 - \$34.1 million) of at-need sales of funeral merchandise and services and \$16.4 million (2005 - \$14.6 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 six months of 2006 totalled \$24.7 million compared to \$22.7 million in the 2005, an increase of \$2.0 million or 8.7%. Of the \$2.0 million increase, \$1.8 million was related to the new funeral homes acquired in the Ottawa, Ontario area.

Investment and other income in the funeral division decreased by \$0.2 million or 7.3% to \$2.2 million in the first six months of 2006. The reduction was mainly attributable to a decrease in the fees received from the deposit of pre-need funeral funds under the group annuity program, which 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.

Funeral expenses in the period increased by \$4.3 million or 12.3%, of which \$3.6 million was related to new operations. Excluding the impact of new operations, expenses increased by \$0.7 million or 1.9%. A breakdown of the \$4.3 million increase by type of expenditure follows (in \$millions):

Cost of sales	1.0
Services	2.3
Facilities	0.4
Motor equipment	0.2
Depreciation and amortization	0.2
Other	0.2
	<u>4.3</u>

The increase in the cost of sales expense was related to the increase in sales. The cost of sales percentage increased by 0.2 of a percentage point. Of the \$2.3 million increase in services expense, \$2.0 million was incurred by new operations. Service expenses of existing operations increased by 2.2% in the period due mainly to an increase in employee costs. The remaining expense increase of \$1.0 million was attributable to new operations.

Earnings before interest expense and income taxes in the funeral division increased by \$0.9 million or 5.6%, to \$17.3 million in the first six months of 2006. The \$0.9 million increase was attributable to new operations.

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 \$0.7 million in the first six months of 2006 compared to \$0.6 million in the first six months of 2005 due to an increase in investment income.

Corporate expenses increased by \$0.7 million or 11.5%, to \$7.0 million in the period due mainly 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 \$0.4 million. The increases in these expenses were partially offset by decreases in other corporate expenses. As a percentage of total Company revenue, corporate expenses for the first six months of 2006 increased to 6.6% from 6.3% in the same period of 2005.

CONSOLIDATED BALANCE SHEETS

Key financial indicators for the balance sheets as at April 30, 2006 and October 31, 2005 are as follows:

	<u>April 30,</u> <u>2006</u>	<u>October 31,</u> <u>2005</u>
Current ratio (ratio:1)	3.02	2.53
Working capital (in \$millions)	49.8	46.2

Long-term debt to equity ratio (ratio:1)	0.52	0.44
Long-term debt to EBITDA ratio (ratio:1) ⁽¹⁾	2.30	1.91
Interest coverage ratio (ratio:1) ⁽¹⁾	5.51	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 \$3.6 million from October 31, 2005 due to a decrease in current liabilities of \$5.7 million compared to a decrease in current assets of \$2.1 million. The decrease in current liabilities was due to a decrease in accounts payable and accrued liabilities while the decrease in current assets was principally due to a reduction in cash from \$11.0 million at October 31, 2005 to \$6.5 million at April 30, 2006. The decrease in cash was partially offset by increases in other current asset balances.

The long-term debt to equity ratio and the long-term debt to EBITDA bank covenant increased by 0.08:1 and 0.39:1 respectively due to new debt of \$19.9 million that was borrowed in the first quarter to partially finance the acquisition of 7 funeral homes for \$24.0 million.

Cash decreased by \$4.4 million from October 31, 2005 to April 30, 2006 mainly due to \$4.1 million in cash used to partially finance the acquisition of 7 funeral homes in the first quarter. Payment of fiscal year-end accruals such as bonuses, vacation pay and dividends also had an impact.

Accounts receivable increased by \$0.7 million in the quarter due to new accounts receivable balances of the 7 funeral homes acquired in the first quarter of 2006.

Accounts receivable arising from at-need cemetery sales were paid on average within 48 days at April 30, 2006 (October 31, 2005 – 47 days). Accounts receivable arising from at-need funeral sales were paid on average within 30 days at April 30, 2006 (October 31, 2005 – 31 days).

Prepaid expenses were \$0.9 million at April 30, 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 \$25.0 million or 5.5% to \$476.7 million at the end of the second quarter, of which \$17.6 million was related to 7 new funeral homes acquired in the first quarter of 2006. The remaining increase of \$7.4 million or 1.6% 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 April 30, 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 \$77.0 million, compared to \$67.0 million at October 31, 2005. Of the \$10.0 million increase, \$1.1 million was related to the 7 new funeral homes acquired in the first quarter of 2006. The accumulated benefit of these contracts is not included in the Company's balance sheet.

Cemetery care funds increased by \$5.2 million or 3.6% in the first six 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 \$4.9 million or 3.7% in the first six months of 2005.

Crypts and niches decreased by \$1.0 million or 3.8% to \$25.3 million due to crypts and niches sold in the period of \$3.8 million, offset by additions of \$2.8 million. The \$2.8 million in additions (first six months of 2005 – \$2.1 million) included:

- \$1.1 million for a mausoleum expansion at Highland Memory Gardens in Toronto, Ontario;
- \$0.7 million for a new interior niche building at Fairhaven Memorial Gardens in Moncton, New Brunswick;
- \$0.5 million for a mausoleum expansion at Capital Memorial Gardens in Ottawa, Ontario; and
- \$0.5 million in other expenditures.

Fixed assets in the first six months of 2006 increased by \$15.1 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 \$5.4 million in other additions, which were partially offset by \$4.8 million in depreciation. The \$5.4 million in non-acquisition additions included the following:

- \$1.7 million for cemetery maintenance capital fixed assets, including the development or renovation of cemetery sales offices and service buildings;
- \$1.3 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;
- \$1.3 million for funeral maintenance capital fixed assets;
- \$0.5 million for further development of a funeral home building addition in Edmonton, Alberta; and
- \$0.6 million for other fixed asset additions.

The cemetery fixed asset and building additions included \$0.3 million for development of a new road at Glenview Memorial Gardens, a cemetery that opened in the fourth quarter of 2002 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 financial statements provides details of the purchase allocation.

Deferred obtaining costs and stored merchandise increased by \$1.5 million or 2.1% in the period, mainly due to a higher amount of commissions deferred in the quarter compared to commissions recognized as a result of deliveries of the underlying contract merchandise and services. Stored merchandise increased by \$0.2 million or 1.4%.

Intangible and other assets increased in the first six months of 2006 by \$2.3 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 \$0.2 million.

Accounts payable and accrued liabilities decreased by \$4.7 million as follows (in \$millions):

Trade accounts payables	2.0
Accrued liabilities	1.8
Other accounts payable	0.9
	<u>4.7</u>

The decrease in trade accounts payable was due mainly to lower construction and development payables and accruals of \$1.3 million at April 30, 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.

Long-term debt at April 30, 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 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 \$652.6 million at the end of the second quarter of 2006 compared to \$619.2 million at October 31, 2005, an increase of \$33.4 million or 5.4%. Of the \$33.4 million increase, \$17.6 million was related to the 7 new funeral homes acquired in the first quarter of 2006. The remaining increase of \$15.8 million or 2.6% represented deferral of revenue in the period in excess of amounts recognized upon delivery of merchandise and services.

Future income taxes increased by \$1.8 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.

CONSOLIDATED STATEMENTS OF CASH FLOWS

THREE MONTHS ENDED APRIL 30, 2006

Net cash provided by operating activities of continuing operations in the second quarter of 2006 increased by \$1.3 million from the second quarter of 2005 due to a higher positive net change in other operating balance sheet items of \$2.9 million, partially offset by higher additions to developed land, crypts and niches of \$1.8 million.

The higher net change in other operating balance sheet items compared to the three months ended April 30, 2005 was mainly due to a larger decrease in accounts receivable of \$1.2 million, a larger increase in income taxes payable of \$0.8 million and a larger increase in accounts payable and accrued liabilities of \$0.6 million.

Net cash used for investing activities of continuing operations increased by \$3.2 million in the second quarter of 2006 compared to the same period of 2005, due mainly to the purchase of a parcel of cemetery land for future development for \$2.8 million.

Net cash provided by financing activities of continuing operations increased by \$0.6 million over the second quarter of 2005 due to higher increases in non-controlling interests in both pre-need funds and cemetery care funds.

SIX MONTHS ENDED APRIL 30, 2006

Net cash provided by operating activities of continuing operations in the first six months of 2006 increased by \$6.1 million from the same period of 2005 mainly due to a lower negative net change in other operating balance sheet items. 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 six months of 2005 of \$2.8 million compared to an increase in income taxes payable in the first six months of 2006 of \$1.7 million as well as a larger decrease in accounts payable in the first six months of 2005 compared to the same period of 2006 of \$1.7 million. 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 April 30, 2006 compared to April 30, 2005 due to taxes that became payable in 2006 on the sale of a parcel of land sold subject to a mortgage receivable in 2003. The larger decrease in accounts payable was due to a higher balance at October 31, 2004 compared to October 31, 2005 of \$2.0 million due to a higher level of construction and development activity at the end of 2004.

Net cash used for investing activities of continuing operations increased by \$27.2 million in the first six months of 2006 mainly due to the acquisition of 7 funeral homes in the quarter for \$24.0 million and the purchase of a parcel of cemetery land for future development for \$2.8 million.

Net cash provided by financing activities of continuing operations increased by \$19.9 million over the first six months of 2005 due to new debt borrowed to partially finance the acquisition of 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 April 30, 2006			
	<u>Jul-31/05</u>	<u>Oct-31/05</u>	<u>Jan-31/06</u>	<u>Apr-30/06</u>
Revenue (\$millions)	48.6	50.9	50.8	55.9
Net earnings (\$millions) ⁽¹⁾	3.1	4.2	4.4	6.4
Basic earnings per share (\$) ⁽²⁾	0.30	0.38	0.42	0.61
	Four Fiscal Quarters Ended April 30, 2005			
	<u>Jul-31/04</u>	<u>Oct-31/04</u>	<u>Jan-31/05</u>	<u>Apr-30/05</u>
Revenue (\$millions)	46.1	54.2	48.1	51.4
Net earnings (\$millions) ⁽¹⁾	3.0	5.3	4.5	5.7
Basic earnings per share (\$) ⁽²⁾	0.28	0.50	0.43	0.54

⁽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 over the same quarter of 2005 due to sales of new funeral operations of \$2.2 million, an increase of \$0.9 million in sales of existing funeral operations and an increase in the

delivery of at-need cemetery merchandise and services of \$1.2 million. 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 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 three quarters due to the improvement in sales in both the cemetery and funeral divisions.

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 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 April 30, 2006:

Highland Memory Gardens – mausoleum extension: As at April 30, 2006, the Company had spent \$1.1 million on this project. The Company expects to spend an additional \$0.3 million to complete this project and expects to have the project completed in the third quarter of 2006.

Capital Memorial Gardens – mausoleum extension: As at April 30, 2006, the Company had spent \$0.6 million on this project. The Company expects to spend an additional \$0.8 million to complete this project and expects to have the project completed in the third quarter of 2006.

Fairhaven Memorial Gardens – interior niche structure: As at April 30, 2006, the Company had spent \$0.7 million on this project. The Company expects to spend an additional \$0.3 million to complete this project and expects to have the project completed in the third quarter of 2006.

Greenlawn Memorial Gardens/Victoria Memorial Gardens – reception centre: As at April 30, 2006, the Company had spent \$0.6 million on this project. The Company estimates that an additional \$3.3 million will be spent to complete this project and anticipates completing the project in fiscal 2007.

In addition, at April 30, 2006, the Company had \$21.6 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 April 30, 2006 (in \$millions):

Cemetery burial space inventory	0.9
Cemetery maintenance capital expenditures	<u>1.0</u>
	<u>1.9</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 January 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	10.1
New cemetery and funeral initiatives	7.0
Cemetery burial space inventory	<u>7.5</u>
	<u>24.6</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 April 30, 2006, the Company had access to unused operating lines of credit of \$12.9 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 of \$19.9 million established on the acquisition of 7 funeral homes.

The Company's debt to equity ratio at April 30, 2006 was 0.52:1 (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 April 30, 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.

STOCK INFORMATION

The symbol for the Company's Class B Non-Voting shares changed from "ABO.NV.B" to "ABO.B" effective May 17, 2006.

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 proposed a new levy on pre-need funeral contracts in the province. The levy, if enacted, would come into effect for Arbor in the third quarter of fiscal 2006. At this time, the Company is investigating the impact of this measure and is in discussion with the Council regarding the validity of the proposed levy.

At April 30, 2006, the Ontario Ministry of Government Services ("OMGS") had released five of the anticipated seven regulation segments relating to the Funeral Burial and Cremation Services Act ("FBCSA"). The OMGS intends 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 regulations remains unknown, it is possible that they could be proclaimed in the second half of calendar 2007.

May 30, 2006

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS

<i>In \$000</i>	<i>Three Months Ended April 30</i>		<i>Six Months Ended April 30</i>	
	<i>2006</i>	<i>2005 ⁽¹⁾</i>	<i>2006</i>	<i>2005 ⁽¹⁾</i>
Revenue				
Sales	52,107	47,655	99,439	92,245
Investment and other income	3,750	3,786	7,259	7,335
	55,857	51,441	106,698	99,580
Expenses				
Operating	41,466	38,923	81,107	76,010
Corporate	3,548	3,118	7,029	6,302
	45,014	42,041	88,136	82,312
Earnings before interest expense and income taxes	10,843	9,400	18,562	17,268
Interest expense	1,278	1,037	2,468	2,060
Earnings before income taxes	9,565	8,363	16,094	15,208
Income taxes (note 8)	3,199	2,680	5,338	5,017
Net earnings from continuing operations	6,366	5,683	10,756	10,191
Net earnings from discontinued operations (note 9)	46	9	86	38
Net earnings	6,412	5,692	10,842	10,229
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	0.61	0.54	1.01	0.97
Earnings per share from discontinued operations	-	-	0.01	-
Earnings per share - basic and fully diluted (in \$)	0.61	0.54	1.02	0.97

⁽¹⁾ Restated - see note 9.

UNAUDITED CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

<i>In \$000</i>	<i>Three Months Ended April 30</i>		<i>Six Months Ended April 30</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
Retained earnings, beginning of period	104,892	88,216	100,462	83,679
Net earnings for the period	6,412	5,692	10,842	10,229
Retained earnings, end of period	111,304	93,908	111,304	93,908

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED BALANCE SHEETS

<i>In \$000</i>	<i>April 30</i> 2006	<i>As at</i> <i>October 31</i> <i>2005⁽¹⁾</i>
Assets		
Current assets		
Cash	6,533	10,954
Accounts receivable	18,446	17,770
Merchandise inventories	9,702	9,437
Prepaid expenses	931	450
Assets related to discontinued operation, current portion (note 9)	121	116
Pre-need receivables, current portion	38,690	38,214
	74,423	76,941
Pre-need receivables and funds	437,968	413,445
Cemetery care funds	150,321	145,105
Crypts and niches	25,261	26,247
Cemetery land	33,939	31,339
Fixed assets	182,487	167,351
Goodwill	55,152	44,336
Mortgage receivable	13,500	13,669
Deferred obtaining costs and stored merchandise	70,222	68,763
Assets related to discontinued operation (note 9)	3,683	3,704
Intangible and other assets (note 4)	3,032	758
	1,049,988	991,658
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	22,462	27,117
Income taxes payable	2,137	721
Long-term debt, current portion (note 5)	13	2,443
	24,612	30,281
Deferred revenue (note 6)	175,689	174,975
Non-controlling interests in pre-need funds	399,924	377,237
Long-term debt (note 5)	96,085	73,720
Future income taxes (note 8)	5,543	3,757
Liabilities related to discontinued operation (note 9)	2,922	2,948
Other liabilities	11,089	10,674
	715,864	673,592
Non-controlling interests in cemetery care funds	150,321	145,105
Shareholders' equity		
Share capital (note 7)	72,499	72,499
Retained earnings	111,304	100,462
	183,803	172,961
	1,049,988	991,658

(1) Prepaid expenses and Intangible and other assets restated to conform with current year's presentation.

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>In \$000</i>	<i>Three Months Ended April 30</i>		<i>Six Months Ended April 30</i>	
	2006	2005 ⁽¹⁾	2006	2005 ⁽¹⁾
Cash provided by (used for)				
Operating activities	6,412	5,692	10,842	10,229
Net earnings				
Deduct net earnings from discontinued operations (note 9)	(46)	(9)	(86)	(38)
Add (deduct) items not affecting cash from operating activities:				
Depreciation and amortization	2,450	2,068	4,879	4,126
Gain on disposal of assets	(114)	(65)	(128)	(84)
Provision for asset impairment	-	30	-	30
Future income taxes (note 8)	(523)	73	(1,336)	300
Developed land, crypt and niche cost of sales	2,197	2,439	4,232	4,564
Additions to developed land, crypts and niches	(2,167)	(416)	(2,997)	(2,194)
Net change in other operating balance sheet items (note 11)	5,877	2,954	(5,069)	(12,660)
Net cash provided by continuing operations	14,086	12,766	10,337	4,273
Net cash provided by discontinued operations	32	7	78	60
Investing activities				
Additions to fixed assets	(2,468)	(3,706)	(5,443)	(6,924)
Acquisition (note 2)	(16)	-	(23,997)	-
Additions to cemetery land held for future development	(2,843)	(5)	(2,849)	(17)
Proceeds on disposal of assets	117	209	131	230
Change in pre-need funds	(3,184)	(2,142)	(7,133)	(5,622)
Change in cemetery care funds	(2,486)	(2,075)	(5,216)	(4,936)
Net cash used for continuing operations	(10,880)	(7,719)	(44,507)	(17,269)
Net cash provided by discontinued operations	18	1,341	25	1,299
Financing activities				
Proceeds from new long-term debt (note 2)	-	-	19,942	-
Repayment of long-term debt	(4)	(3)	(7)	(7)
Dividends	-	-	(742)	(742)
Change in non-controlling interests in pre-need funds	2,261	2,061	5,264	5,587
Change in non-controlling interests in cemetery care funds	2,486	2,075	5,216	4,936
Net cash provided by continuing operations	4,743	4,133	29,673	9,774
Net cash used for discontinued operations	(20)	(47)	(27)	(53)
Increase (decrease) in cash	7,979	10,481	(4,421)	(1,916)
Cash (bank indebtedness), beginning of period	(1,446)	(1,996)	10,954	10,401
Cash, end of period	6,533	8,485	6,533	8,485
Supplementary information				
Income taxes paid	2,576	2,031	5,432	7,464
Interest paid	1,332	1,024	2,470	2,093

⁽¹⁾ Restated - see note 9.

ARBOR MEMORIAL SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Six Months Ended April 30, 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.

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. A provision will be made 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 funds	17,423
Fixed assets	14,545
Intangible asset subject to amortization	953
Intangible asset not subject to amortization	1,145
	<hr/>
	35,404

Liabilities assumed:	
Accounts payable and accrued liabilities	1,525
Non-controlling interests in pre-need funds	17,423
Future income taxes	<u>3,275</u>
	<u>22,223</u>
Net assets acquired	13,181
Goodwill arising on acquisition	<u>10,816</u>
Total consideration	<u>23,997</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 April 30, 2006, the accumulated benefit of all such contracts was \$77.0 million (October 31, 2005 - \$67.0 million).

4. INTANGIBLE AND OTHER ASSETS

	<u>April 30</u> <u>2006</u>	<u>October 31</u> <u>2005</u>
	(\$000)	
Intangible asset subject to amortization	923	-
Intangible asset not subject to amortization	1,145	-
Other assets	<u>964</u>	758
	<u>3,032</u>	<u>758</u>

The intangible asset subject to amortization at April 30, 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 six months ended April 30, 2006 (first six months of 2005 – \$nil).

5. DERIVATIVE FINANCIAL INSTRUMENTS

As of April 30, 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 \$45.8 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 50% (October 31, 2005 – 66%) of the total amount of long-term debt outstanding. Swap costs for the first six months of 2006 were \$0.4 million (first six months of 2005 - \$0.7 million).

6. DEFERRED REVENUE

Sales that have not yet been recognized in revenue, and that are included in instalment accounts receivable, 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 April 30, 2006, \$37.2 million (October 31, 2005 – \$36.2 million) of deferred revenue related to instalment accounts receivable that will be deposited to legislated trust funds upon collection, representing 55% (October 31, 2005 – 53%) of the total outstanding instalment accounts receivable.

7. SHARE CAPITAL

Issued and outstanding

	<u>April 30</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>

8. INCOME TAXES

Income tax expense

Income tax expense for the three and six months ended April 30 consisted of the following:

	<u>Three Months Ended</u> <u>April 30</u>		<u>Six Months Ended</u> <u>April 30</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
	(\$000)		(\$000)	
Current tax expense	3,722	2,607	6,674	4,717
Future income tax expense	(523)	73	(1,336)	300
	<u>3,199</u>	<u>2,680</u>	<u>5,338</u>	<u>5,017</u>

Effective income tax rate

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

	<u>Three Months Ended</u> <u>April 30</u>		<u>Six Months Ended</u> <u>April 30</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
	%		%	
Combined basic federal and provincial income tax rate	34.5	34.2	34.3	34.1
Increase (decrease) in the basic tax rate resulting from:				
Large corporations tax	-	0.6	0.2	0.8
Non-taxable portion of capital gains	(0.1)	(0.4)	(0.7)	(0.6)
Dividends/RDTOH	(0.7)	(1.2)	(0.8)	(0.8)
Recovery of prior year over-provision	(0.4)	(1.6)	(0.2)	(0.9)
Other changes	0.1	0.4	0.4	0.4
Effective income tax rate	<u>33.4</u>	<u>32.0</u>	<u>33.2</u>	<u>33.0</u>

Net future income tax liability

The net future income tax liability is comprised of:

	<u>April 30, 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	56,140	20,250	56,571	20,275
Cancellation/chargeback provisions	7,818	2,820	7,087	2,540
Deferred losses on pre-need contracts	1,313	474	1,214	435
Other	2,792	1,007	2,638	945
	<u>68,063</u>	<u>24,551</u>	<u>67,510</u>	<u>24,195</u>

Future income tax liabilities:

Reserves claimed for future delivery of cemetery land and merchandise	(43,883)	(15,829)	(49,494)	(17,739)
Excess of share acquisition costs over book value	(19,165)	(6,913)	(11,059)	(3,964)
Deferred expenses	(10,916)	(3,937)	(10,765)	(3,858)
Excess of net book value over tax value of capital assets	(5,061)	(1,826)	(4,283)	(1,535)
Intangible assets	(2,068)	(746)	-	-
Pre-need trust income	(1,322)	(477)	(1,353)	(485)
Other	(1,015)	(366)	(1,036)	(371)
	<u>(83,430)</u>	<u>(30,094)</u>	<u>(77,990)</u>	<u>(27,952)</u>
	<u>(15,367)</u>	<u>(5,543)</u>	<u>(10,480)</u>	<u>(3,757)</u>

9. 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 is expected to occur within fiscal 2006.

Revenue associated with discontinued operations was \$0.3 million for the first six months of 2006 (2005 – \$0.4 million). Net earnings for the first six months of 2006 were \$0.1 (2005 – less than \$0.1 million). The comparative amounts for the first six months of 2005 have been reclassified for the funeral branch identified as a discontinued operation in the fourth quarter of 2005.

10. CONTRACTUAL COMMITMENTS

At April 30, 2006, the Company was contractually committed to capital and cemetery burial space inventory expenditures of \$1.9 million. The Company expects that all of these commitments will be spent within one year from April 30, 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.

11. NET CHANGE IN OTHER OPERATING BALANCE SHEET ITEMS

	<i>Three Months</i>		<i>Six Months</i>	
	<i>Ended April 30</i>		<i>Ended April 30</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>(\$000)</i>		<i>(\$000)</i>	
Accounts receivable	1,550	367	128	(594)
Prepaid expenses	522	334	(481)	(646)
Pre-need receivables	(704)	(834)	(443)	338
Deferred obtaining costs and stored merchandise	(978)	(1,033)	(1,459)	(1,778)
Accounts payable and accrued liabilities	3,051	2,482	(5,438)	(7,183)
Income taxes payable	1,453	701	1,673	(2,780)
Deferred revenue	865	1,449	714	595
Other	118	(512)	237	(612)
	<u>5,877</u>	<u>2,954</u>	<u>(5,069)</u>	<u>(12,660)</u>

12. SEGMENT DISCLOSURE

Industry segments (\$000)

	<i>Three Months Ended April 30 (\$000)</i>							
	<i>Cemetery</i>		<i>Funeral</i>		<i>Corporate</i>		<i>Consolidated</i>	
	2006	2005	2006	2005	2006	2005	2006	2005
	(3)							
Sales ⁽¹⁾	23,871	22,476	28,087	25,033	149	146	52,107	47,655
Investment and other income ⁽¹⁾	2,328	2,327	1,210	1,286	212	173	3,750	3,786
Revenue ⁽¹⁾	26,199	24,803	29,297	26,319	361	319	55,857	51,441
Depreciation and amortization ⁽¹⁾	792	743	1,290	1,170	368	155	2,450	2,068
Earnings before interest expense and income taxes ⁽¹⁾	4,510	3,782	9,520	8,417	(3,187)	(2,799)	10,843	9,400
Interest expense	-	-	-	-	1,278	1,037	1,278	1,037
Earnings before income taxes	4,510	3,782	9,520	8,417	(4,465)	(3,836)	9,565	8,363
Capital expenditures	940	1,268	1,504	1,829	24	609	2,468	3,706
Developed land, crypt and niche additions	2,167	416	-	-	-	-	2,167	416
Cemetery land held for future development additions	2,843	5	-	-	-	-	2,843	5
Pre-need contracts written	18,221	17,997	14,211	12,781	-	-	32,432	30,778

	<i>Six Months Ended April 30 (\$000)</i>							
	<i>Cemetery</i>		<i>Funeral</i>		<i>Corporate</i>		<i>Consolidated</i>	
	2006	2005	2006	2005	2006	2005	2006	2005
	(3)							
Sales ⁽¹⁾	44,912	43,109	54,230	48,844	297	292	99,439	92,245
Investment and other income ⁽¹⁾	4,671	4,618	2,189	2,362	399	355	7,259	7,335
Revenue ⁽¹⁾	49,583	47,727	56,419	51,206	696	647	106,698	99,580
Depreciation and amortization ⁽¹⁾	1,571	1,478	2,570	2,335	738	313	4,879	4,126
Earnings before interest expense and income taxes ⁽¹⁾	7,643	6,589	17,252	16,334	(6,333)	(5,655)	18,562	17,268
Interest expense	-	-	-	-	2,468	2,060	2,468	2,060
Earnings before income taxes	7,643	6,589	17,252	16,334	(8,801)	(7,715)	16,094	15,208
Identifiable assets ⁽²⁾	558,774	541,976	466,306	420,421	24,908	29,261	1,049,988	991,658
Capital expenditures	3,276	2,244	1,986	3,714	181	966	5,443	6,924
Developed land, crypt and niche additions	2,997	2,194	-	-	-	-	2,997	2,194
Cemetery land held for future development additions	2,849	17	-	-	-	-	2,849	17
Pre-need contracts written	33,638	33,212	24,681	22,701	-	-	58,319	55,913

(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.