

Second Quarter Report

**Six Months Ended
April 30, 2004**



**ARBOR
MEMORIAL
SERVICES INC.**

Arbor Memorial Services Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Three Months Ended April 30, 2004 Compared to Three Months Ended April 30, 2003

Results of Operations

Net earnings for the quarter ended April 30, 2004, were \$6.3 million or \$0.59 per share compared to \$3.3 million or \$0.31 per share for the same period of 2003. This represented an increase of \$1.4 million or \$0.13 per share over 2003 comparable net earnings after excluding other income (expenses). The increase was due to an improvement in earnings of the cemetery and funeral divisions.

Cemetery Segment

Cemetery sales for the second quarter increased by \$2.5 million or 13.6% to \$21.2 million over 2003. Following is a breakdown of the increase:

	<u>\$Millions</u>	<u>% of Total</u>
Pre-need burial spaces	1.2	49.7
Pre-need merchandise	0.4	16.5
Pre-need services	-	1.0
At-need burial spaces	0.2	6.0
At-need merchandise	0.4	15.0
At-need services	0.3	11.8
	<u>2.5</u>	<u>100.0</u>

The increase in pre-need burial space sales was led by higher sales of pre-need crypts of \$0.7 million due largely to the opening of the second through fourth floors of the new mausoleum at Glendale Memorial Gardens in Toronto, Ontario in October 2003. Of the \$0.7 million increase in at-need merchandise and services, \$0.5 million was due to merchandise and services delivered or performed in prior years. Through administrative efforts in the current year, the Company was able to update delivery dates on the system and thereby recognize these sales in revenue.

Investment income increased by \$0.1 million or 5.0% to \$2.2 million due to higher income on the care funds. The average balance of care funds for the second quarter of 2004 increased \$8.1 million or 6.8% from the same period last year, while the annualized return decreased by 0.1 of a percentage point to 5.8%.

Cost of sales increased by \$1.2 million or 12.9%, due to the increase in sales. The gross margin percentage on cemetery sales for the quarter increased by 0.3 of a percentage point compared to the second quarter of 2003.

Selling expenses increased by \$0.3 million or 8.0% over the second quarter of 2003. The increase was due to higher managerial commissions as a result of the increase in sales and higher labour costs and employee benefits, due to regular annual increases. Care and maintenance expenses increased by \$0.1 million or 3.8%, due to higher labour costs including employee benefits.

Earnings from cemetery operations before other income (expenses) increased by \$0.9 million or 30.3% from the comparable prior year period.

In the second quarter of 2004, the number of interments performed by the Company increased by 173 or 4.7% to 3,888 and the number of cremations increased by 87 or 2.4% to 3,639. The amount of pre-need contracts written increased by \$2.3 million or 15.7% to \$17.1 million.

In the second quarter of 2004, the Company opened a reception centre on the site of an existing cemetery in Oakville, Ontario.

Arbor Memorial Services Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Funeral Segment

Funeral home sales for the second quarter of 2004 increased over the second quarter of 2003 by \$1.4 million or 6.6%. The increase in sales was the result of an improvement in the number of calls of 138 or 2.9% as well as an improvement in the average sale per funeral service performed of \$163 or 3.6%. Management believes that an overall increase in the death rate across North America was partially responsible for the increase in the number of calls in the period. At-need funeral sales increased by 6.9% in the quarter, while the delivery of pre-need funeral sales into current period revenue increased by 6.1%.

Investment income increased by \$0.1 million or 9.4% over the first quarter of 2003 to \$1.1 million. The increase was due to higher fees received from the deposit of pre-need funds under the Company's group annuity program.

Cost of sales increased by \$0.5 million or 14.0% in the quarter, largely due to the increase in sales and additional pre-need funeral commissions of \$0.3 million expensed in the period related to prior years' sales. The gross margin on funeral sales for the quarter decreased by 1.1 percentage points due to the prior year pre-need commissions expensed.

Other operating expenses increased by \$0.7 million or 5.8% due largely to higher employee costs of \$0.3 million, which were driven by regular annual increases, higher bonus accruals of \$0.1 million as a result of the improved earnings for the quarter and higher spending of \$0.2 million on contract labour and supplies.

Earnings from funeral operations before other income (expenses) increased by \$0.3 million or 5.0% to \$7.0 million. The increase was largely due to the growth in sales.

Corporate

Corporate revenue, which comprised rental income from leasing a portion of the Company's head office building for office or retail space and interest income on cash holdings and mortgages receivable, increased by \$0.1 million. This was due largely to interest received on a mortgage receivable that was established in the third quarter of 2003 as a result of the sale of land.

Corporate expenses increased by \$0.2 million or 7.0% to \$3.4 million. The increase was mostly attributable to higher bonus accruals as a result of the improved earnings and higher legal fees due to a corporate reorganization. As a percentage of total Company revenue, corporate expenses decreased from 7.4% for the second quarter of 2003 to 7.2% for the second quarter of 2004.

Interest Expense

Interest expense for the quarter ended April 30, 2004 decreased by \$0.2 million to \$1.1 million over the same quarter of 2003. The decrease was due to a reduction in the average long-term debt balance outstanding for the period of \$16.4 million or 16.9% as a result of principal repayments on the bank term loans over the last twelve months. The repayments were made possible by the sale of land in Markham, Ontario in 2003, the receipt of income taxes receivable related to prior years' reassessments in 2003 and the sale of an equity interest in four funeral homes in 2004. The average rate of interest on long-term debt for the period was 5.3% compared to 5.1% for the same period of 2003 due to an increase in the proportion of fixed rate debt from 55% at October 31, 2003 to 75% at April 30, 2004.

Other Income (Expenses)

During the second quarter, the Company sold its equity investment in four funeral homes for a gain of \$1.3 million and provided \$0.3 million for the impairment of assets. Of the \$0.3 million, \$0.25 million was related to one funeral home. The carrying value of the funeral home was written down to its estimated realizable value.

Arbor Memorial Services Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Also during the quarter, the Company recorded income of \$0.7 million related to the settlement of prior years' income taxes. As part of the interment rights reserve settlement with Canada Revenue Agency ("CRA"), non-deductible interest on taxes payable was eligible to be offset against refund interest on taxes receivable, effective January 1, 2000. In conjunction with CRA, the Company estimated a benefit of \$0.2 million in 2003. The actual benefit, once processed for all years and all companies by CRA, was determined to be \$0.8 million. The remaining \$0.1 million was the result of various other adjustments based on actual notices of reassessment received.

Income Taxes

The Company's effective tax rate decreased 13.6 percentage points, from 38.2% in the second quarter of 2003 to 24.6% in the same period of 2004. The decrease was mostly due to the non-taxable portion of the sale of an equity interest in four funeral homes, which reduced income taxes by \$0.2 million, additional non-taxable net interest income recognized on the settlement of prior years' income taxes, which reduced income taxes by \$0.3 million, and the recovery of an over-provision related to the large corporations tax in 2003 in the amount of \$0.3 million. A reduction in the combined basic federal and provincial income tax rate, due largely to a lower federal rate and a corporate reorganization, also reduced income taxes by approximately \$0.2 million. The corporate reorganization occurred at the end of January 2004 and is expected to reduce the Company's current tax provision by an estimated \$0.5 million on an annual basis.

Consolidated Cash Flows

The Company had positive cash flow from operating activities for the second quarter of 2004 of \$6.1 million compared to \$1.7 million for the same period of 2003. The improvement was largely due to lower additions to developed land, crypts and niches of \$3.6 million and higher net earnings after adjusting for non-cash items of \$0.9 million. The higher additions to developed land, crypts and niches in 2003 were largely due to the construction of two new mausoleums in Toronto, Ontario.

The net change in other operating balance sheet items was negative \$2.0 million compared to negative \$1.5 million in 2003. The three largest variances within the net change follow.

- The net change in pre-need receivables increased by \$9.0 million, of which \$5.0 million was due to additional non-recurring funding made in the period for pre-need installation fees related to bronze memorials. The remaining increase of \$4.0 million was due to contributions to the funds at a higher rate than withdrawals due to deliveries in the period. Pre-need cemetery sales written in the period were up by \$2.3 million or 15.7% compared to the prior year.
- The net change in deferred revenue increased by \$5.4 million due to additions to the balance based on current sales written in the period at a higher rate than removal of deferred revenue due to delivery into current period revenue.
- Accounts payable and accrued liabilities increased by \$2.5 million compared to a decrease of \$0.8 million in the comparable prior year period. The increase in the quarter compared to last year was largely due a higher level of construction and development activity.

Cash provided by investing activities was \$1.4 million in the second quarter of 2004, compared to cash used for investing activities of \$2.3 million in the second quarter of 2003. The main reason for the improvement was \$6.2 million received in cash proceeds on the disposition of an equity interest in four funeral homes in Ottawa, Ontario, but this increase was partially offset by higher additions to fixed assets of \$3.0 million. In the second quarter of 2004, the Company incurred:

- \$1.4 million to replace an existing funeral home in Richmond, British Columbia;
- \$1.7 million to replace existing funeral home and cemetery fixed assets;
- \$0.7 million for the development of a reception centre at a cemetery in Oakville, Ontario; and
- \$0.5 million to develop a new funeral home in Markham, Ontario.

Cash used for financing activities increased by \$5.6 million over the comparable prior year period due to higher repayments of long-term debt. The Company applied \$5.6 million of the \$6.2 million in proceeds from the sale of its equity investment to the outstanding term loans.

Arbor Memorial Services Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Six Months Ended April 30, 2004 Compared to Six Months Ended April 30, 2003

Results of Operations

Net earnings for the six months ended April 30, 2004, were \$11.0 million or \$1.04 per share compared to \$7.0 million or \$0.66 per share for the same period of 2003. This represented an increase of \$2.4 million or \$0.22 per share over 2003 comparable net earnings after excluding other income (expenses). The increase was largely due to an improvement in earnings of the funeral and cemetery divisions.

Cemetery Segment

Cemetery sales for the first six months increased by \$3.1 million or 8.2% to \$40.7 million over 2003. Following is a breakdown of the increase:

	<u>\$Millions</u>	<u>% of Total</u>
Pre-need burial spaces	1.2	39.9
Pre-need merchandise	0.2	6.5
Pre-need services	0.1	4.3
At-need burial spaces	0.5	16.1
At-need merchandise	0.6	18.2
At-need services	0.5	15.0
	<u>3.1</u>	<u>100.0</u>

The increase in pre-need burial space sales was led by higher sales of pre-need crypts of \$0.8 million due largely to the opening of the second through fourth floors of the new mausoleum at Glendale Memorial Gardens in Toronto, Ontario in October 2003. Management believes that an overall increase in the death rate across North America was partially responsible for the \$1.6 million increase in at-sales in the period. In addition, \$0.5 million of the at-need merchandise and services sales increase was due to merchandise and services delivered or performed in prior years. Through administrative efforts in the current year, the Company was able to update delivery dates on the system and thereby recognize these sales in revenue.

Investment income increased by \$0.3 million or 6.4% to \$4.4 million due to higher income on the care funds. The average balance of care funds for the period increased \$8.2 million or 6.9% over last year, while the annualized return was 0.1 of a percentage point higher for 2004 at 5.8%.

Cemetery cost of sales increased by \$1.4 million or 7.9% due to the increase in sales. The gross margin percentage on cemetery sales for the period was lower than the first six months of 2003 by 0.2 of a percentage point.

Selling expenses increased by \$0.3 million or 4.6% over the first six months of 2003. The increase was largely due to higher managerial commissions as a result of the increase in sales and higher labour costs and employee benefits, due to regular annual increases. Care and maintenance expenses increased by \$0.3 million or 4.2%, mostly due to higher labour costs including employee benefits.

Earnings from cemetery operations before other income (expenses) increased \$0.9 million or 15.7% from the comparable prior year period due largely to the increase in sales.

In the first six months of 2004, the number of interments performed by the Company increased by 451 or 5.8% to 8,168 and the number of cremations increased by 369 or 5.2% to 7,430. The amount of pre-need contracts written increased by \$3.1 million or 10.8% to \$31.8 million.

In the second quarter of 2004, the Company opened a reception centre on the site of an existing cemetery in Oakville, Ontario.

Arbor Memorial Services Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Funeral Segment

Funeral home sales for the first six months of 2004 increased over the first six months of 2003 by \$3.5 million or 8.1%. The increase in sales was the result of an improvement in the number of calls of 447 or 4.7% as well as an improvement in the average sale per funeral service performed of \$143 or 3.1%. Management believes that an overall increase in the death rate across North America was partially responsible for the increase in the number of calls in the period. At-need funeral sales increased by 8.2% in the period, while the delivery of pre-need funeral sales into current period revenue increased by 7.4%.

Investment income increased by \$0.2 million or 9.5% over the first six months of 2003 to \$2.2 million. The increase was due to higher fees received from the deposit of pre-need funds under the Company's group annuity program.

Cost of sales increased by \$0.7 million or 9.7% in the period, largely due to the increase in sales. The gross margin on funeral sales for the first six months decreased by 0.3 of a percentage point due to additional pre-need funeral commissions expensed in the period related to prior years.

Other operating expenses increased by \$1.5 million or 6.0% due largely to an increase in service costs of \$0.9 million. Approximately half of the increase in service costs or \$0.4 million was due to higher bonus accruals as a result of the improved earnings for the period, while the remainder of the increase was spread amongst a number of expense categories including other employee costs, contract labour and supply purchases.

Earnings from funeral operations before other income (expenses) increased by \$1.6 million or 11.4% to \$15.3 million. The increase was largely due to the growth in sales.

Corporate

Corporate revenue, which comprised rental income from leasing a portion of the Company's head office building for office or retail space and interest income on cash holdings and mortgages receivable, increased by \$0.3 million. This was largely due to interest received on a mortgage receivable that was established in the third quarter of 2003 as a result of the sale of land.

Corporate expenses increased by \$0.4 million or 7.3% to \$6.5 million. The increase was mostly attributable to the receipt of \$0.2 million from Service Corporation International in 2003 due to the settlement in the Company's favour of the costs of defending itself in a prior year's lawsuit as well as higher bonus accruals as a result of the improved earnings for the period. As a percentage of total Company revenue, corporate expenses decreased from 6.9% for the first six months of 2003 to 6.8% for the first six months of 2004.

Interest Expense

Interest expense for the six months ended April 30, 2004 decreased by \$0.4 million or 17.0% to \$2.1 million over the same period of 2003. The decrease was due to a reduction in the average long-term debt balance outstanding for the period of \$16.4 million or 16.9% as a result of principal repayments on the bank term loans over the last twelve months. The repayments were made possible by the sale of land in Markham, Ontario in 2003, the receipt of income taxes receivable related to prior years' reassessments in 2003 and the sale of an equity interest in four funeral homes in 2004. The average rate of interest on long-term debt for the period was 5.3% compared to 5.1% for the same period of 2003 due to an increase in the proportion of fixed rate debt from 55% at October 31, 2003 to 75% at April 30, 2004.

Other Income (Expenses)

During the first half of 2004, the Company sold its equity investment in four funeral homes for a gain of \$1.3 million and provided \$0.3 million for impairment of assets. Of the \$0.3 million, \$0.25 million related to one funeral home. The carrying value of the funeral home was written down to its estimated realizable value.

Arbor Memorial Services Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Also during the first half of 2004, the Company recorded income of \$0.7 million related to the settlement of prior years' income taxes. As part of the interment rights reserve settlement with Canada Revenue Agency ("CRA"), non-deductible interest on taxes payable was eligible to be offset against refund interest on taxes receivable, effective January 1, 2000. In conjunction with CRA, the Company estimated a benefit of \$0.2 million in 2003. The actual benefit, once processed for all years and all companies by CRA, was determined to be \$0.8 million. The remaining \$0.1 million was the result of various other adjustments based on actual notices of reassessment received.

Income Taxes

The Company's effective tax rate decreased 7.7 percentage points, from 38.2% in the first half of 2003 to 30.5% in the same period of 2004. The decrease was mostly due to the non-taxable portion of the sale of an equity interest in four funeral homes, which reduced income taxes by \$0.2 million, additional non-taxable net interest income recognized on the settlement of prior years' income taxes which reduced income taxes by \$0.3 million and the recovery of an over-provision related to the large corporations tax in 2003 in the amount of \$0.3 million. A reduction in the combined basic federal and provincial income tax rate, due largely to a lower federal rate and a corporate reorganization, also reduced income taxes by approximately \$0.4 million. The corporate reorganization was completed at the end of January 2004 and is expected to reduce the Company's current tax provision by an estimated \$0.5 million on an annual basis.

Consolidated Cash Flows

The Company had positive cash flow from operating activities for the second quarter of 2004 of \$5.5 million compared to negative cash flow of \$4.7 million for the same period of 2003. The \$10.2 million improvement was largely due to the following:

- lower additions to developed land, crypts and niches of \$4.9 million;
- an improvement in the net change in other operating balance sheet items of \$2.6 million;
- higher net earnings after adjusting for non-cash items of \$2.0 million.

Of the \$2.6 million improvement in net change in other operating balance sheet items, \$2.5 million was due to the receipt of income tax balances owing from prior years' reassessments and \$3.8 million was due to a decrease in accounts payable and accrued liabilities of \$5.8 million compared to a decrease of \$9.6 million in 2003. Accounts payable were particularly low at the end of April 2003 due to a generally low level of construction and development activity. Offsetting these positive factors was a decrease in cash due to a higher comparable increase in pre-need receivables. The higher increase was largely due to additional non-recurring funding made in the period of \$5.0 million related to pre-need installation fees for bronze memorials.

Cash used for investing activities was \$0.9 million in the first six months of 2004, compared to \$3.8 million in 2003. The main reason for the improvement was \$6.2 million received in cash proceeds on the disposition of an equity interest in four funeral homes in Ottawa, Ontario, but this increase was partially offset by higher additions to fixed assets and acquisitions of \$3.3 million. In the first half of 2004, the Company incurred:

- \$2.4 million to replace an existing funeral home in Richmond, British Columbia;
- \$2.2 million to replace existing funeral home and cemetery fixed assets;
- \$1.3 million for the development of a reception centre at a cemetery in Oakville, Ontario;
- \$0.6 million to develop a new funeral home in Markham, Ontario; and
- \$0.4 million for further development of a new computer system for cemetery and funeral operations.

Cash used for financing activities increased by \$5.6 million over the comparable prior year period due to higher repayments of long-term debt. The Company applied \$5.6 million of the \$6.2 million in proceeds from the sale of its equity investment to the outstanding bank term loans.

Arbor Memorial Services Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Consolidated Balance Sheets as at April 30, 2004 and October 31, 2003

Key Financial Indicators

Changes to the key financial indicators since the end of the 2003 fiscal year follow:

- the current ratio increased to 2.61 from 2.35, largely due to a reduction of \$6.5 million in accounts payable and accrued liabilities;
- the debt to equity ratio decreased to 0.51:1 from 0.59:1;
- the long-term debt to EBITDA ratio decreased to 2.04 from 2.35; and
- the interest coverage ratio relative to earnings from operations before other income (expenses) increased to 5.05 times from 4.35 times.

The decreases in the debt to equity ratio and the long-term debt to EBITDA ratio were largely due to principal repayments on the bank term loans in the period.

Accounts Receivable

Accounts receivable arising from at-need cemetery sales at April 30, 2004 represented 52 days of 2004 sales, compared to 51 days at October 31, 2003. Accounts receivable arising from at-need funeral sales at April 30, 2004 represented 32 days of 2004 sales, compared to 31 days at October 31, 2003.

Income Taxes Receivable

Income taxes receivable decreased by \$2.5 million from October 31, 2003 to April 30, 2004 as a result of the receipt of amounts related to prior years' income tax reassessments with respect to reserves claimed on the sale of interment rights.

Pre-Need Receivables and Deferred Revenue

Pre-need receivables increased by \$21.1 million since the end of fiscal 2003, while deferred revenue increased by \$14.3 million. The increase in both balances was largely due to contributions at a higher rate than the delivery of contracts at the time of need. However, the increase in pre-need receivables was also due to additional non-recurring funding made in the period of \$5.0 million related to pre-need installation fees for bronze memorials. Pre-need cemetery sales written in the first half of 2004 were up by \$3.1 million or 10.8% compared to 2003.

Other Assets

Other assets decreased by \$4.3 million largely due to the sale of an equity interest in four funeral homes in Ottawa, Ontario.

Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities decreased by \$6.5 million from October 31, 2003 to April 30, 2004 due largely to higher balances at the end of the 2003 fiscal year including higher trade payables of \$2.4 million, higher income taxes payable of \$2.3 million, accrued bonuses of \$1.3 million and higher dividends payable of \$0.7 million. The higher trade payables balance is largely timing related. The higher income taxes payable at October 31, 2003 were largely related to amounts payable of \$1.9 million on the sale of land in 2003 and \$2.3 million that was payable on the net interest income received in connection with the settlement of prior years' taxes.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Long-Term Debt

Long-term debt at the end of the period decreased by \$5.7 million from October 31, 2003, due largely to principal repayments on the bank term loans. The principal repayments were made possible by the sale of an equity interest in four funeral homes in the period for \$6.2 million. The Company's long-term debt at April 30, 2004 consisted of \$75.6 million under the banks' revolving term loans and \$1.9 million of an obligation under capital lease.

Risks 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 burial spaces can also have seasonal fluctuations, whereby sales are generally lower in the winter months.

Regulation

The Ontario Government has released for comment one of seven sections of the new regulations respecting funeral and cemetery operations in Ontario. At this time, the Company estimates that all of the sections of this legislation will be completed within twelve months. The new regulations include, among other matters, rules of operation for funeral homes located on cemetery properties.

The Government of British Columbia passed new consumer protection legislation in March 2004. The new legislation provides for a new governing agency to regulate cemeteries, funeral homes and crematoria. The agency will be funded by regulatory fees charged to the industry. However, the new fees should not negatively impact the Company's results as these fees have traditionally been passed on to the customer. The Company anticipates that this legislation will be in force in July 2004.

The Company is continuing to make changes to its policies, procedures and practices to comply with the new federal and provincial privacy legislation. The estimated cost of these initiatives is not expected to exceed \$0.1 million and includes such items as legal advice, training, reprinting of contracts and cemetery by-laws, and system changes.

The Canada Revenue Agency issued a draft technical bulletin regarding the application of GST/HST to cemetery property and services in May 2004. The Company is in the process of reviewing this bulletin and determining what impact, if any, it will have on its operations.

Future Accounting Changes

In 2003, the Canadian Accounting Standards Board approved a new accounting guideline on the consolidation of variable interest entities. The guideline is harmonized with a U.S. Financial Accounting Standards Board Interpretation and will be effective for the Company in fiscal 2005. Several of the U.S. public companies in the death care industry have had discussions with the U.S. Securities and Exchange Commission concerning the implementation of the Interpretation. At issue is the consolidation of the pre-need cemetery and funeral trust funds, consolidation of the care trust funds and the recognition of the associated investment earnings of the trust funds. The Company is currently evaluating the impact of the new guideline on its accounting policies.

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS

	<i>Three Months Ended</i>		<i>Six Months Ended</i>	
	<i>April 30</i>		<i>April 30</i>	
	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>
	<i>(\$000)</i>		<i>(\$000)</i>	
Revenue				
Sales	44,158	40,198	87,831	81,203
Investment and other income	3,550	3,232	6,946	6,213
	47,708	43,430	94,777	87,416
Expenses				
Operating	36,697	33,727	72,197	67,599
General and administrative	3,429	3,205	6,480	6,040
	40,126	36,932	78,677	73,639
Earnings from operations before other income (expenses)	7,582	6,498	16,100	13,777
Other income (expenses)				
Gain on disposal of assets (note 3)	1,376	39	1,399	43
Provision for asset impairment (note 3)	(300)	-	(300)	-
Settlement of prior years' income taxes	725	-	725	-
	1,801	39	1,824	43
Earnings from operations	9,383	6,537	17,924	13,820
Interest expense	1,059	1,243	2,109	2,541
Earnings before income taxes	8,324	5,294	15,815	11,279
Income taxes (note 2)	2,050	2,020	4,820	4,309
Net earnings	6,274	3,274	10,995	6,970
Weighted average number of shares outstanding (in thousands)	10,595	10,595	10,595	10,595
Earnings per share - basic	\$ 0.59	\$ 0.31	\$ 1.04	\$ 0.66
Earnings per share - fully diluted	\$ 0.59	\$ 0.31	\$ 1.04	\$ 0.66

UNAUDITED CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

	<i>Three Months Ended</i>		<i>Six Months Ended</i>	
	<i>April 30</i>		<i>April 30</i>	
	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>
	<i>(\$000)</i>		<i>(\$000)</i>	
Retained earnings - beginning of period	73,559	47,908	68,838	44,212
Net earnings for the period	6,274	3,274	10,995	6,970
Retained earnings - end of period	79,833	51,182	79,833	51,182

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED BALANCE SHEETS

	<i>As at</i>	
	<i>April 30</i>	<i>October 31</i>
	<i>2004</i>	<i>2003</i>
	<i>(\$000)</i>	
Assets		
Current assets		
Cash	6,493	8,279
Accounts receivable	16,915	16,042
Merchandise inventories	9,995	10,136
Income taxes receivable	21	2,512
Pre-need receivables, current portion	38,602	38,325
	72,026	75,294
Pre-need receivables	428,916	408,132
Crypts and niches	28,244	30,653
Cemetery land	29,177	30,211
Fixed assets	152,486	148,997
Goodwill	44,765	44,765
Future income taxes	734	707
Mortgages receivable	13,675	13,761
Other assets	1,339	5,681
	771,362	758,201
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	22,649	29,186
Long-term debt, current portion	4,956	2,797
	27,605	31,983
Deferred revenue	511,956	497,627
Long-term debt	72,520	80,367
Other liabilities	6,949	6,887
	619,030	616,864
Shareholders' equity		
Share capital (note 4)	72,499	72,499
Retained earnings	79,833	68,838
	152,332	141,337
	771,362	758,201

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	<i>Three Months Ended</i>		<i>Six Months Ended</i>	
	<i>April 30</i>		<i>April 30</i>	
	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>
	(\$000)		(\$000)	
Cash provided by (used for)				
Operating activities				
Net earnings	6,274	3,274	10,995	6,970
Add (deduct) items not affecting cash from operating activities:				
Depreciation	1,982	1,909	3,948	3,799
Gain on disposal of assets (note 3)	(1,376)	(39)	(1,399)	(43)
Provision for asset impairment (note 3)	300	-	300	-
Future income taxes	(581)	506	(27)	1,077
Additions to developed land, crypts and niches	(627)	(4,230)	(1,522)	(6,428)
Developed land, crypt and niche cost of sales	2,195	1,753	4,279	3,638
Net change in other operating balance sheet items (note 6)	(2,047)	(1,519)	(11,108)	(13,750)
	6,120	1,654	5,466	(4,737)
Investing activities				
Additions to fixed assets	(4,826)	(1,882)	(7,102)	(3,129)
Additions to cemetery land held for future development	(3)	(13)	(11)	(31)
Acquisitions (note 3)	-	(493)	-	(673)
Proceeds on disposal of assets	6,223	44	6,291	48
	1,394	(2,344)	(822)	(3,785)
Financing activities				
Repayments of long-term debt	(5,631)	(59)	(5,688)	(120)
Dividends	-	-	(742)	(742)
	(5,631)	(59)	(6,430)	(862)
Increase (decrease) in cash	1,883	(749)	(1,786)	(9,384)
Cash (bank indebtedness), beginning of period	4,610	(1,026)	8,279	7,609
Cash (bank indebtedness), end of period	6,493	(1,775)	6,493	(1,775)
Supplementary information				
Income taxes paid	1,635	1,785	7,905	3,531
Interest paid	1,015	1,224	2,079	2,533

Arbor Memorial Services Inc.

UNAUDITED NOTES TO INTERIM CONSOLIDATED FINANCIAL RESULTS
Six Months Ended April 30, 2004

1. Basis of Preparation

The accompanying unaudited quarterly consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and consistent with the accounting policies used to prepare the 2003 annual consolidated financial statements. While management considers the interim disclosures presented to be adequate, these consolidated financial statements and notes should be read in conjunction with the Company's 2003 annual consolidated financial statements.

2. Income Taxes

The Company follows the asset and liability method of accounting for income taxes, whereby future income tax assets and liabilities are recognized for temporary differences between their accounting and tax bases. Future income tax assets and liabilities are measured using substantively enacted income tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period of substantive enactment.

The Company's income tax expense consisted of the following:

	<i>April 30</i>	
	<i>2004</i>	<i>2003</i>
	<i>(\$000)</i>	
Current tax expense	4,847	3,232
Future income tax expense relating to the origination and reversal of temporary differences	(27)	1,077
Income tax expense	4,820	4,309

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

	<i>April 30</i>	
	<i>2004</i>	<i>2003</i>
	%	%
Combined basic federal and provincial income tax rate	35.4	37.8
Increase (decrease) in the basic tax rate resulting from:		
Non-taxable settlement of prior years' income taxes	(1.6)	-
Non-taxable portion of gain on sale of equity interest	(1.5)	-
Non-taxable dividends	(0.9)	(1.3)
Large corporations tax ⁽¹⁾	(0.6)	2.0
Settlement of litigation costs ⁽²⁾	-	(0.8)
Other items	(0.3)	0.5
Effective income tax rate	30.5	38.2

⁽¹⁾ 2004 reflects a recovery of a 2003 over-provision of \$0.3 million. Excluding this over-provision, the rate impact would have been 1.3%.

⁽²⁾ For tax purposes, these costs were non-deductible in the year they were incurred.

3. Acquisitions, Dispositions and Asset Impairment

In the second quarter of 2004, the Company sold its equity interest in four funeral homes for cash consideration of \$6.2 million. The pre-tax gain on the sale was \$1.3 million and the after-tax gain was \$1.1 million. In the first six months of 2003, the Company acquired a flower shop for cash consideration of \$0.2 million and certain assets of a funeral home for cash consideration of \$0.5 million.

In the second quarter of 2004, the Company recognized impairment of the fixed assets of one funeral operation in the amount of \$0.25 million before income taxes. The loss in value of the funeral operation was calculated by comparing the estimated market value assessment to the net book value and resulted from continuing underperformance of the operation. Also in the second quarter of 2004, the Company increased its provision for slow-moving crypts and niches by \$0.05 million.

Arbor Memorial Services Inc.

UNAUDITED NOTES TO INTERIM CONSOLIDATED FINANCIAL RESULTS
Six Months Ended April 30, 2004

4. Share Capital

The Company's issued and outstanding share capital is as follows:

	<i>April 30</i>	
	<i>2004</i>	<i>2003</i>
	<i>(000)</i>	
Number of Class A Voting Shares	2,525	2,525
Number of Class B Non-Voting Shares	8,070	8,070
Shares issued and outstanding	<u>10,595</u>	<u>10,595</u>

There were no dilutive options outstanding and there were no options granted or exercised in either the current or prior period. Following is a summary of the share purchase options issued, outstanding and exercisable at April 30, 2004.

Number of Shares	Exercise Price	Expiry	Exercise Date
112,300	\$19.25	June 2, 2005	exercisable currently
45,000	\$29.36	January 29, 2007	exercisable currently
131,300	\$23.50	December 17, 2007	exercisable currently

The weighted-average exercise price was \$22.76 and the weighted-average remaining contractual life was 2.5 years for the issued, outstanding and exercisable share purchase options at April 30, 2004.

Under the provisions of the Company's 1994 stock option plan, directors, officers, full-time employees and part-time employees are eligible to receive options to purchase Class B Non-Voting shares. According to the plan, the option price can not be lower than the closing price per share on the Toronto Stock Exchange on the last trading day immediately preceding the granting of the options. Options granted have a maximum term of 10 years and vesting requirements are determined by the Board of Directors at the time of the grant. The aggregate number of shares for which options may be granted can not exceed 10% of the aggregate of the issued Class A Voting shares and the issued Class B Non-Voting shares outstanding from time to time. Initially, the 1994 stock option plan was authorized to issue 878,789 options and of that number, 691,000 options have been granted.

The Company will account for any new stock option grants using the fair value method. Under the fair value method, compensation expense for stock options that are direct awards of stock is measured at fair value at the grant date using an option-pricing model and recognized over the vesting period.

5. Derivative Financial Instruments

Derivative financial instruments are utilized by the Company in the management of its interest rate exposure on long-term debt. The company does not enter into financial instruments for trading or speculative purposes. Interest rate swap agreements are used as part of the Company's program to manage the fixed and floating interest rate mix of the Company's total debt portfolio and overall cost of borrowing. The interest rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based and are recorded as an adjustment of interest expense on the debt instrument. The related amount payable to or receivable from counter-parties is included as an adjustment to accrued interest.

As of April 30, 2004, the Company's use of interest rate swap agreements was limited to seven (October 31, 2003 - five) interest rate swaps with a Canadian chartered bank, whereby the Company has fixed a portion of its term loan financing at interest rates ranging from 4.6% to 6.2% plus a bank margin. At April 30, 2004, these swaps had a total notional amount of \$56.3 million (October 31, 2003 - \$43.8 million). Two of the swaps amortize quarterly on a straight-line basis and will be fully amortized in 2008, while the remaining swaps expire in 2006 through 2014. The swaps and other fixed rate debt represented 75% (October 31, 2003 - 55%) of the total amount of long-term debt outstanding.

The fair value of the swaps is estimated as the discounted unrealized gain or loss calculated based on the market price at April 30, 2004, which generally reflects the estimated amount that the Company would receive or pay to terminate the contracts at the balance sheet date. The estimated fair value of the interest rate swaps was a loss of \$2.4 million (October 31, 2003 - loss of \$2.1 million). Losses due to non-performance by the counter-party are not anticipated due to their high credit standing. Swap costs in the first six months of 2004 were \$0.7 million (first six months of 2003 - \$0.6 million).

Arbor Memorial Services Inc.

UNAUDITED NOTES TO INTERIM CONSOLIDATED FINANCIAL RESULTS
Six Months Ended April 30, 2004

5. Derivative Financial Instruments (continued)

All of the Company's interest rate swaps are designated as cash flow hedges. At April 30, 2004, the critical terms of the swaps did not match the terms of the underlying floating rate debt. Therefore, the hypothetical derivative method was used to perform a quantitative, retrospective assessment of the effectiveness of the swaps. This methodology involved regression analysis of historical interest rates for the floating rate portion of the swaps and historical interest rates for the underlying debt. The result of the analysis was that the fair value of the cash flows from the interest rates of the swaps were highly effective at offsetting the variability in cash flows from the interest rates of the underlying debt. Therefore, hedge accounting was afforded.

6. Net Change in Other Operating Balance Sheet Items

	<i>Three Months Ended</i>		<i>Six Months Ended</i>	
	<i>April 30</i>		<i>April 30</i>	
	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>
	<i>(\$000)</i>		<i>(\$000)</i>	
Accounts receivable	171	50	(873)	(704)
Income taxes receivable	1,158	-	2,491	-
Merchandise inventories	(310)	434	141	(494)
Pre-need receivables	(13,497)	(4,527)	(21,061)	(16,319)
Accounts payable and accrued liabilities	2,504	(791)	(5,795)	(9,624)
Deferred revenue	7,482	2,061	14,329	12,737
Other changes	445	1,254	(340)	654
	<u>(2,047)</u>	<u>(1,519)</u>	<u>(11,108)</u>	<u>(13,750)</u>

7. Guarantees

The Company is contingently liable for the pre-need obligations of nine cemeteries that were sold in prior years. Five of these cemeteries were sold by the Company in fiscal 1999 and 2000. The Company's best estimate of its maximum potential exposure for these five cemeteries is \$2.0 million, which represents the difference between the current cost to fulfill these obligations and the amount of pre-need funds in trust. The remaining four cemeteries were sold over 10 years ago and the Company is unable to quantify the maximum potential exposure.

Arbor Memorial Services Inc.

UNAUDITED NOTES TO INTERIM CONSOLIDATED FINANCIAL RESULTS
Six Months Ended April 30, 2004

8. Segment Disclosure

	<i>Three Months Ended April 30 (\$000)</i>							
	<i>Cemetery</i>		<i>Funeral</i>		<i>Corporate</i>		<i>Consolidated</i>	
	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>
Sales	21,155	18,621	22,855	21,433	148	144	44,158	40,198
Investment and other income	2,234	2,128	1,124	1,027	192	77	3,550	3,232
	23,389	20,749	23,979	22,460	340	221	47,708	43,430
Interest expense	-	-	-	-	1,059	1,243	1,059	1,243
Depreciation	684	644	1,095	1,049	203	216	1,982	1,909
Earnings (loss) from operations before other income (expenses)	3,700	2,840	6,971	6,642	(3,089)	(2,984)	7,582	6,498
Other income (expenses)	(33)	38	1,109	1	725	-	1,801	39
Earnings from operations	3,667	2,878	8,080	6,643	(2,364)	(2,984)	9,383	6,537
Capital expenditures	2,378	1,080	2,193	1,010	255	285	4,826	2,375
Cemetery land, crypt and niche additions	630	4,243	-	-	-	-	630	4,243
Pre-need contracts written	17,142	14,815	11,279	11,585	-	-	28,421	26,400
	<i>Six Months Ended April 30 (\$000)</i>							
	<i>Cemetery</i>		<i>Funeral</i>		<i>Corporate</i>		<i>Consolidated</i>	
	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>	<i>2004</i>	<i>2003</i>
Sales	40,673	37,581	46,865	43,348	293	274	87,831	81,203
Investment and other income	4,403	4,137	2,161	1,974	382	102	6,946	6,213
	45,076	41,718	49,026	45,322	675	376	94,777	87,416
Interest expense	-	-	-	-	2,109	2,541	2,109	2,541
Depreciation	1,357	1,274	2,182	2,087	409	438	3,948	3,799
Earnings (loss) from operations before other income (expenses)	6,628	5,731	15,277	13,710	(5,805)	(5,664)	16,100	13,777
Other income (expenses)	(25)	42	1,124	1	725	-	1,824	43
Earnings from operations	6,603	5,773	16,401	13,711	(5,080)	(5,664)	17,924	13,820
Identifiable assets ⁽¹⁾	322,097	294,766	425,716	406,111	23,549	22,113	771,362	722,990
Capital expenditures	3,513	1,999	3,127	1,278	462	525	7,102	3,802
Cemetery land, crypt and niche additions	1,533	6,459	-	-	-	-	1,533	6,459
Pre-need contracts written	31,772	28,688	21,390	21,219	-	-	53,162	49,907

⁽¹⁾ Identifiable assets for 2003 were restated to conform with the current year's presentation.