

First Quarter Report

**Three Months Ended
January 31, 2007**



**ARBOR
MEMORIAL
SERVICES INC.**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis for Arbor Memorial Services Inc. ("Arbor" or the "Company") has been prepared for the three months ended January 31, 2007 and includes material information available up to March 1, 2007. The financial data provided has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and all figures provided are in Canadian dollars. Management's Discussion and Analysis herewith provided is the responsibility of the Company's management. The Board of Directors is responsible for reviewing and approving Management's Discussion and Analysis. Additional information relating to Arbor, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com.

Information Regarding Forward-Looking Statements

Certain statements contained in this Management's Discussion and Analysis including, but not limited to, information regarding the status and progress of the Company's operating and capital activities, the plans and objectives of the Company and assumptions regarding the Company's future performance are forward-looking statements. Forward-looking statements may include words such as "believes", "may", "should", "estimates", "continues", "indicates", "suggests", "anticipates", "intends", "plans", "expects" and similar expressions. These forward-looking statements are based on current expectations and various factors and assumptions. Accordingly, these forward-looking statements are subject to certain risks and uncertainties. The material factors and assumptions that were applied in making the forward-looking statements in this Management's Discussion and Analysis include, but are not limited to: reliance on third-party reports from government bodies and industry associations, the use of economic forecasts prepared by various financial institutions, historical experience, and financial reporting of competitors and suppliers. Risks and uncertainties that could cause or contribute to actual results differing from such statements include, but are not limited to, those discussed elsewhere in this Management's Discussion and Analysis, particularly under "Risks, Events and Uncertainties", and in the Company's 2006 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.

Non-GAAP Financial Measures

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

NEW ACCOUNTING POLICIES

Financial Instruments

In 2005, the Canadian Institute of Chartered Accountants ("CICA") issued new accounting standards concerning financial instruments: Financial Instruments – Recognition and Measurement ("Section 3855"); Hedges ("Section 3865"); and Comprehensive Income ("Section 1530"). The standards require prospective application and are effective for the Company's first quarter of fiscal 2007.

Section 1530 introduces the concept of comprehensive income, which consists of net income and other comprehensive income (loss) ("OCI"), and represents changes in Shareholders' equity during a period arising from transactions with non-owners. OCI includes among its components, unrealized gains and losses on financial

assets classified as “available for sale” and changes in the fair value of the effective portion of cash flow hedging instruments together with income tax expenses or benefits associated with each component. As a result of the implementation of this section, our Consolidated Financial Statements include a Consolidated Statement of Comprehensive Income, while the cumulative amount of OCI, which is termed “accumulated other comprehensive loss” or “AOCL”, is presented as a new category of shareholders’ equity in the Consolidated Balance Sheets.

Section 3855 establishes standards for recognizing and measuring financial instruments and non-financial derivatives. On application of Section 3855, the Company classified the investments in the pre-need cemetery and funeral trust funds and the investments in the cemetery care funds as “available for sale” and changed the basis of measurement for these assets from cost to fair value in the Consolidated Balance Sheets. Unrealized gains and losses on these “available for sale” financial assets are excluded from net earnings and initially recorded net of income taxes as a component of OCI in the Consolidated Statement of Comprehensive Income.

The cemetery and funeral trust funds were measured at fair value at November 1, 2006 and the resulting unrealized net gain of \$9.5 million was initially recorded to OCI, net of income taxes of \$3.3 million, and subsequently reclassified to either “Non-controlling interests in pre-need funds” or “Deferred revenue”. The funds were then remeasured at fair value at January 31, 2007 and the increase in the fair value of \$0.7 million was initially recorded to OCI, net of income taxes of \$0.2 million, and subsequently reclassified to either “Non-controlling interests in pre-need funds” or “Deferred revenue”. In accordance with the Section, however, the prior period comparative figures at October 31, 2006 were not restated to fair value and are therefore presented at book value.

Similarly, the cemetery care funds were measured at fair value at November 1, 2006 and the resulting unrealized net gain of \$6.1 million was initially recorded to OCI, net of income taxes of \$2.2 million, and subsequently reclassified to “Non-controlling interests in cemetery care funds”. The funds were then remeasured at fair value at January 31, 2007 and the decrease in the fair value of \$0.5 million was initially recorded to OCI, net of income taxes of \$0.2 million, to “Non-controlling interests in cemetery care funds”. In accordance with the Section, however, the prior period comparative figures at October 31, 2006 were not restated to fair value and are therefore presented at book value.

All other financial assets and financial liabilities are classified and measured as follows:

<u>Asset/Liability</u>	<u>Classification</u>	<u>Measurement</u>
Accounts receivable	Loans and receivables	Amortized cost
Instalment accounts receivable	Loans and receivables	Amortized cost
Mortgage receivable	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Long-term debt	Other liabilities	Amortized cost

Section 3865 establishes standards for when and how hedge accounting may be applied. The Company’s derivative financial instruments, which consist of interest rate swap agreements that have been designated as cash flow hedges, have also been reported at fair value as a result of the implementation of Section 3855 and Section 3865. The unrealized gains and losses that arise as a result of remeasuring the swap agreements at their fair value at the end of each period are recognized, net of income taxes, in OCI. To date there has not been any ineffectiveness in these cash flow hedges. The estimated fair value of the interest rate swaps at January 31, 2007 was a loss of \$0.6 million (October 31, 2006 – loss of \$0.9 million), which was recorded in “Other liabilities”. The reduction in the loss in the quarter ended January 31, 2007 of \$0.3 million has been recorded, net of income taxes, in OCI. The accumulated loss at November 1, 2006 of \$0.9 million was recorded, net of income taxes of \$0.3 million, as a transition adjustment to opening AOCL.

Section 3855 requires that interest income and expense be allocated over the relevant period using the effective interest method (EIM). Under the EIM, interest income and expense is calculated and recorded using an effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the initial net carrying amount of the financial asset or liability. Transaction costs that are directly attributable to the acquisition or issue of financial instruments classified as other than “held for trading” are included in the initial carrying value of such instruments and amortized using the EIM. As a result of implementing this Section, the Company has recorded the interest income and expense related to all financials assets and liabilities using the EIM. The change to the EIM did not result in any significant differences to the Company’s current calculation of interest income and expense.

In accordance with Section 3855, the Company conducted a search for embedded derivatives in all contractual arrangements dated subsequent to October 31, 2002 and did not identify any embedded features that required separate presentation from the related host contract.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JANUARY 31, 2007 COMPARED TO THE THREE MONTHS ENDED JANUARY 31, 2006

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

TOTAL COMPANY RESULTS

Revenue for the quarter ended January 31, 2007 was \$55.3 million compared to \$50.7 million for the quarter ended January 31, 2006. This represented an increase of \$4.6 million or 9.1%. Sales contributed \$4.4 million of the increase, while investment and other income contributed \$0.2 million. Following is a breakdown of total revenue:

	<u>2007</u>		<u>2006</u>	
	<u>\$Millions</u>	<u>% of Total</u>	<u>\$Millions</u>	<u>% of Total</u>
Sales				
Cemetery	22.0	39.8	21.1	41.6
Funeral	29.5	53.3	26.0	51.3
Corporate	0.1	0.2	0.1	0.2
	<u>51.6</u>	<u>93.3</u>	<u>47.2</u>	<u>93.1</u>
Investment and other income	<u>3.7</u>	<u>6.7</u>	<u>3.5</u>	<u>6.9</u>
	<u>55.3</u>	<u>100.0</u>	<u>50.7</u>	<u>100.0</u>

Sales increased by \$4.4 million or 9.3% in the first quarter of 2007 compared to the first quarter of 2006. Sales in the cemetery division increased by \$0.9 million or 4.3%, sales in the funeral division increased by \$3.5 million or 13.4%, while sales in the corporate division remained consistent at \$0.1 million. Of the \$3.5 million increase in the funeral division, \$0.8 million was related to new operations. Sales from existing operations in the funeral division increased by \$2.7 million or 11.2%.

Investment and other income increased by \$0.2 million or 6.8% over 2006 due to higher fees received on the deposit of pre-need funeral funds under the group annuity program and an increase in interest and dividends received on the cemetery care funds.

Operating expenses increased by \$2.8 million or 7.0% over 2006. Cemetery division expenses increased by \$1.2 million or 5.9%, due mainly to an increase in cost of sales of \$0.9 million. Funeral division expenses increased by \$1.6 million or 8.3%, due mainly to increases in cost of sales and services expenses as a result of the improvement in sales, annual increases in salaries and wages and increased accrued bonuses. Of the \$1.6 million increase in the funeral division, \$1.3 million was related to existing operations, which represented an increase of 7.5%.

Corporate expenses increased by less than \$0.1 million or 1.2% to \$3.5 million, largely due to an increase in employee compensation.

Earnings before interest expense and income taxes ("EBIT") were \$9.5 million, which represented an increase of \$1.8 million or 23.2% over 2006. The increase was driven by the funeral division, which improved by \$2.0 million or 26.0% over the first quarter of 2006 due to higher sales. Partially offsetting the increase in the funeral division was a decrease in the earnings of the cemetery division of \$0.2 million, which was mainly the result of a reduction of \$0.4 million in cost of sales provisions in 2006. Of the \$1.8 million increase in total Company EBIT, \$1.2 million was attributable to existing operations, which represented an increase of 16.7%.

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 less than \$0.1 million or 3.9% to \$1.2 million in the first quarter of 2007 due to a higher average floating rate of interest of 5.1% compared to 3.9% in the first quarter of 2006. Offsetting the negative impact of the higher average floating rate, however, was lower swap costs of \$0.2 million compared to the first quarter of 2006. The overall weighted average rate of interest on long-term debt for the period was 5.4% compared to 4.9% in 2006.

The weighted average long-term debt balance decreased by \$4.3 million or 4.4% due to repayments on the bank term loans in the fourth quarter of 2006. The proportion of fixed-rate debt at January 31, 2007 was 48% compared to 49% at October 31, 2006 and 51% at January 31, 2006.

Income taxes for the first quarter of 2007 resulted in an effective tax rate of 34.5% compared to 32.8% in the first quarter of 2006. The 1.7 percentage point increase in the rate was due to higher net capital gains recognized in the first quarter of 2006 compared to 2007, which decreased the effective rate in 2006 by 1.5 percentage points and the effect of future income tax changes, which increased the effective rate in 2007 by 1.1 percentage points. These items were partially offset by a decrease in the effective rate in the first quarter of 2007 as a result of the elimination of the large corporations tax and other items.

Net earnings and earnings per share were \$5.4 million and \$0.51 per share in the first quarter of 2007 compared to \$4.4 million and \$0.42 per share in the first quarter of 2006. This represented an increase in net earnings of \$1.0 million or 22.1%. The improvement in earnings was attributable to the funeral division and of the \$1.0 million increase, new operations contributed \$0.3 million.

CEMETERY DIVISION

Cemetery sales in the first quarter of 2007 increased by \$0.9 million or 4.3% over 2006 to \$22.0 million. Sales in the year, including finance charges and net of cancellation allowances, consisted of:

- \$7.9 million (2006 – \$7.2 million) of pre-need sales of interment rights;
- \$6.2 million (2006 – \$6.4 million) of pre-need sales of merchandise and services, recognized when merchandise was delivered or services were performed, including income earned on related pre-need trust funds; and
- \$7.8 million (2006 – \$7.4 million) of at-need sales of interment rights and deliveries of at-need merchandise and services.

The following is a breakdown of the \$0.9 million increase in cemetery sales (in \$millions):

<u>At-Need</u>	
Interment rights	0.4
Merchandise	(0.3)
Services	<u>0.3</u>
	<u>0.4</u>
<u>Pre-Need</u>	
Interment rights	0.7
Merchandise	(0.3)
Services	<u>0.1</u>
	<u>0.5</u>
	<u><u>0.9</u></u>

The increase in at-need interment rights of \$0.4 million or 20.9% was due to a higher number of interments in the period of 8.0% compared to the first quarter of 2006, which is generally indicative of a higher rate of death and a higher average selling price per burial space of 12.9%. The higher average selling price was due to mix of sales by product line, product type and branch location as well as an increase in the average selling price of individual products. The increase in pre-need interments rights was mainly due to a group sale of traditional burial lots of \$0.5 million.

The decrease in the delivery of at-need merchandise of \$0.3 million was due to lower deliveries of upright monuments of \$0.2 million. The lower amount of monument deliveries was partially related to lower contracts written in 2006 compared to 2005 of 8.1% but was also timing-related.

The decrease in the delivery of pre-need merchandise of \$0.3 million was due to lower deliveries of upright monuments of \$0.4 million. The lower amount of monument deliveries was timing-related since pre-need monument contracts written in 2005 and 2006 increased by 11.7% and 5.7% respectively. In particular, in the first quarter of 2006, the Company took receipt of and delivered a large order of pre-need monuments that increased pre-need monument sales by approximately \$0.3 million.

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

- the timing of full payment by the customer;

- the amount of time it takes for customers to approve the manufacture and delivery of their marker;
- the amount of time it takes for orders to be submitted to the manufacturers; and
- the amount of time it takes to manufacture the markers.

The \$0.3 million or 13.6% increase in deliveries of at-need services was due to higher rates of interment and cremation of 8.0% and 2.9% respectively and a higher average sale amount per interment and cremation service.

In the first quarter of 2007, the number of interments performed by the Company increased by 8.0% to 4,224 and the number of cremations increased by 2.9% to 3,780 compared to the first quarter of 2006. For comparative purposes, interments decreased by 0.2% and cremations increased by 1.4% in fiscal 2006 as compared to fiscal 2005.

Cemetery investment income for the quarter increased by less than \$0.1 million or 1.7% over 2006 to \$2.4 million due to an increase in care fund income of \$0.1 million and a decrease in referral fees of less than \$0.1 million. The increase in care fund income of \$0.1 million or 3.8% was due to a higher average balance in the funds of \$11.5 million or 7.9% and occurred despite a decrease in the annualized rate of return on the funds from 5.2% in 2006 to 5.0% in 2007. Interest and dividend income on the care funds is recognized as earned in order to defray cemetery care and maintenance costs. The decrease in referral fees received under the trust program was due to a lower rate of return as a result of reinvestment of a portion of the funds at lower rates.

Interest and dividend income earned on pre-need cemetery merchandise and services trust funds increased by \$0.1 million or 8.0% due to a higher average balance in the funds of \$11.1 million or 6.4%. The rate of return on the funds in the quarter was consistent with the first quarter of 2006 at 3.3%. Interest and dividend income earned on the pre-need trust funds is deferred and recognized as sales revenue when the underlying merchandise is delivered or the service is performed.

Cemetery expenses for the first quarter of 2007 increased by \$1.2 million or 5.9% as follows (in \$millions):

Cost of sales	0.9
Selling	0.1
Administrative	0.1
Other	<u>0.1</u>
	<u>1.2</u>

The increase in cost of sales expense of \$0.9 million was due to the increase in sales and a decrease in two cost of sales provisions based on revised estimates of \$0.4 million in the first quarter of 2006. The cost of sales percentage for 2007 was 47.0%, which was 0.1 of a percentage point higher than the cost of sales percentage for 2006 excluding the \$0.4 million decrease in cost of sales provisions.

EBIT in the cemetery division decreased by \$0.2 million or 7.4%, due mainly to the adjustments to cost of sales in 2006.

FUNERAL DIVISION

As at January 31, 2007, the Company wholly owned 93 funeral homes and two of those funeral homes were classified as discontinued operations.

Funeral sales in the first quarter of 2007 increased by \$3.5 million or 13.4% over the first quarter of 2006 to \$29.5 million. The improvement was attributable to a \$0.8 million increase in sales from new operations and a \$2.7 million or 11.2% increase in sales from existing operations. New operations in the period included seven funeral homes in the Ottawa, Ontario area that were acquired at the beginning of fiscal 2006 and additional calls received at a funeral home in Ajax, Ontario as a result of the availability of a reception centre completed at a nearby cemetery in March 2006.

The increase in sales from existing operations was due to an improvement in the average sale per funeral service of 3.2% and an increase in the number of services of 7.8%. The increase in the average sale per funeral service was the result of the Company's continued efforts to provide customers with value-added merchandise and services, such as receptions, catering, custom printing and ancillary merchandise, as well as regular price increases. The increase in the number of services was partially related to a decrease in existing home services in the first quarter of 2006 compared to the first quarter of 2005 of 2.2% and the Company believes that the remaining increase is a temporary improvement due to a higher number of deaths in the period. The average annual increase in existing home services from 2002 to 2006 was 0.8%.

Sales from existing operations in the period consisted of:

- \$20.0 million (2006 – \$18.0 million) of at-need sales of funeral merchandise and services;
- \$9.4 million (2006 – \$8.0 million) from the fulfilment of merchandise and services sales that were arranged on a pre-need basis; and
- \$0.1 million (2006 - \$0.1 million) of flower shop sales.

Pre-need funeral contracts written in the first quarter of 2007 increased by \$1.6 million or 14.8%. Of the \$1.6 million increase, \$0.8 million was related to the new funeral homes acquired in the Ottawa, Ontario area in the first quarter of 2006. Excluding these contracts, pre-need funeral contracts written increased by 7.1%. Pre-need funeral contracts written under the trust program in the first quarter represented 39.9% (2006 – 47.3%) of total contracts written, while contracts written under the group annuity program represented 60.1% (2006 – 52.7%).

Investment and other income in the funeral division increased by \$0.1 million or 14.4% to \$1.1 million in the first quarter of 2007. The improvement was attributable to an increase in the fees received from the deposit of pre-need funeral funds under the group annuity program of \$0.2 million or 26.0% and a decrease in referral fees under the trust program. The increase in the fees received under the annuity program was the result of an improvement in funeral contracts written of 31.0%. Partially offsetting the impact of the higher number of contracts was a lower payout rate, which is affected by the type of contract and the age of the customer. Funeral referral fees under the trust program decreased by less than \$0.1 million due to reinvestment of a portion of the funds at lower rates and a lower amount of trust contracts being written in the period compared to the first quarter of 2006.

Interest and dividend income earned on the pre-need funeral funds in the quarter increased by \$0.1 million or 3.4% due to a higher average balance in the funds of \$17.5 million or 9.5% and despite a lower annualized rate of return on the funds of 3.4% compared to 3.6% in the first quarter of 2006. The rate of return decreased due to reinvestment of a portion of the funds at lower rates. Interest and dividend income on the pre-need funeral funds is deferred and recognized as sales revenue when the underlying merchandise is delivered or the service is performed.

Funeral expenses in the first quarter of 2007 increased by \$1.6 million or 8.3% over the first quarter of 2006. However, excluding the impact of new operations, expenses increased by \$1.3 million or 7.5%. A breakdown of the \$1.3 million increase in expenses of existing operations by type of expenditure follows (in \$millions):

Cost of sales	0.6
Services	0.6
Other	<u>0.1</u>
	<u><u>1.3</u></u>

The \$0.6 million increase in cost of sales was mainly due to the increase in sales. The cost of sales percentage for existing operations for the quarter was higher than the first quarter of 2006 by 0.6 of a percentage point at 16.1%. However, the percentage was consistent with the percentage for all of fiscal 2006.

The increase in services expenses of \$0.6 million or 7.8% was almost all due to higher employee salaries, wages and bonuses. Salaries were higher in the first quarter of 2007 due to regular annual increases, while the increase in temporary and part-time wages was mainly due to the higher sales. The increase in bonuses was due to the improved results in the division.

EBIT in the funeral division increased by \$2.0 million or 26.0% to \$9.8 million in the first quarter of 2007. The \$2.0 million increase was made up of an increase in earnings of new operations of \$0.6 million and an increase in earnings of existing operations of \$1.4 million or 19.7%. The increase in earnings of existing operations was mainly related to the improvement in sales.

CORPORATE DIVISION

Corporate revenue, consisting of rental income from leasing a portion of the Company's head office building and interest on the Company's bank accounts, short-term investments and a mortgage receivable, increased by \$0.1 million or 14.9% to \$0.4 million in the first quarter of 2007. The increase was due to higher interest income on the mortgage receivable due to renegotiation of the mortgage at the end of the first quarter of 2006 and an increase in interest income on the Company's bank accounts.

Corporate expenses increased by less than \$0.1 million or 1.2%, to \$3.5 million in the first quarter of 2007, due mainly to an increase in salaries as a result of annual increases and an increase in bonuses, which was related to

the improved results. These increases were partially offset by decreases in consulting services, legal fees and termination costs.

As a percentage of total Company revenue, corporate expenses decreased to 6.4% in the first quarter of 2007 from 6.9% in the first quarter of 2006. This was attributable to an increase in revenue of 9.1% with only a 1.2% increase in corporate costs. For comparative purposes, corporate expenses as a percentage of revenue were 6.3% in fiscal 2006, 6.7% in fiscal 2005 and 6.7% in 2004.

CONSOLIDATED BALANCE SHEETS

Key financial indicators for the balance sheets as at January 31, 2007 and October 31, 2006 were as follows:

	January 31 2007	October 31 2006
Current ratio ⁽¹⁾	3.12:1	2.53:1
Working capital (in \$millions) ⁽¹⁾	59.02	53.65
Debt to equity ratio	0.47:1	0.48:1
Long-term debt to EBITDA ⁽²⁾	2.01:1	2.10:1
Interest coverage ratio ⁽²⁾	5.55:1	5.36:1

(1) October 31, 2006 indicator restated based on current year's presentation.

(2) Bank covenant: long-term debt to EBITDA must be less than or equal to 3.5 and interest coverage ratio must equal or exceed 3.25.

The current ratio and working capital increased by 0.59 and \$5.4 million respectively from October 31, 2006 to January 31, 2007, due mainly to a decrease in accounts payable and accrued liabilities of \$6.2 million, a decrease in income taxes payable of \$2.6 million and an increase in accounts receivable of \$3.1 million. The impact of these items was partially offset by a decrease in cash of \$4.3 million and an increase in long-term debt, current portion of \$1.3 million.

Cash decreased by \$4.3 million due mainly to payment of fiscal year-end accruals such as bonuses, vacation pay and dividends and payment of accrued income taxes. For comparison purposes, in the first quarter of 2006, cash decreased by \$8.4 million. However, of the \$8.4 million, \$4.0 million was used to partially finance the acquisition of seven funeral homes.

Accounts receivable increased by \$3.1 million or 15.4% to \$23.1 million due to an increase of \$1.6 million in commodity taxes receivable to recover prior period over-remittances and an increase in the average collection period of both the cemetery and funeral division. For comparison purposes, accounts receivable increased by \$2.2 million in the first quarter of 2006, of which \$1.4 million was related to new operations.

Accounts receivable arising from at-need cemetery sales were paid on average within 45 days at January 31, 2007 compared to 41 days at October 31, 2006 and 53 days at January 31, 2006. Accounts receivable arising from at-need funeral sales were paid on average within 32 days at January 31, 2007 compared to 28 days at October 31, 2006 and 33 days at January 31, 2006.

Pre-need receivables and funds, including the current portion thereof, increased by \$12.4 million or 2.6% to \$493.4 million at January 31, 2007 compared to October 31, 2006. Of the \$12.4 million increase, \$10.2 million was due to a fair value adjustment recorded as a result of the implementation of new accounting standards for financial instruments. Excluding the fair value adjustment, pre-need receivables and funds increased by \$2.2 million or 0.5%. This compared to an increase excluding new operations of \$3.7 million or 0.8% in the first quarter of 2006. The smaller increase in the first quarter of 2007 was mainly due to \$0.9 million in non-recurring funding in the first quarter of 2006 related to a contingent liability for the provision of undelivered pre-need merchandise and services for sold cemeteries and a larger decrease in instalment accounts receivable of \$0.6 million.

Cemetery care funds increased by \$9.0 million or 5.8% in the first quarter of 2007, of which \$5.7 million was due to a fair value adjustment as a result of the implementation of new accounting standards for financial instruments. Excluding the fair value adjustment, cemetery care funds increased by \$3.3 million or 2.1% due to deposits made to the funds as a result of at-need and pre-need cemetery interment right sales. This compared to an increase of \$2.7 million or 1.9% in the first quarter of 2006.

Crypts and niches decreased by \$1.1 million or 4.6% to \$23.0 million due to inventory sold in the quarter of \$1.9 million, which was partially offset by additions of \$0.8 million. The \$0.8 million (first quarter of 2006 – \$0.7 million) spent on crypt and niche inventory in the first quarter of 2007 included:

- \$0.3 million for a combination mausoleum and columbarium at Sunset Memorial Gardens (Thunder Bay, Ontario);
- \$0.2 million for a mausoleum addition at Rideau Memorial Gardens (Montreal, Quebec);
- \$0.2 million for an exterior columbarium at Dartmouth Memorial Gardens (Dartmouth, Nova Scotia); and
- \$0.1 million for other crypt and niche projects.

Fixed assets decreased by \$0.9 million or 0.5% in the first quarter of 2007 due to depreciation of \$2.5 million recorded in the period, which was offset by additions of \$1.6 million (first quarter of 2006 - \$17.5 million, including \$14.5 in assets acquired on the purchase of seven funeral homes). Of the \$1.6 million in additions, \$1.0 million was spent on maintenance capital and \$0.6 million was spent on new initiatives. The more significant projects in the quarter included \$0.3 million for development of a new cemetery sales office at Rideau Memorial Gardens (Montreal, Québec) and \$0.4 million for development of reception centres in Ontario.

Accounts payable and accrued liabilities decreased by \$6.2 million or 23.5% as follows (in \$millions):

Trade accounts payables	(1.6)
Accrued liabilities	(4.2)
Other accounts payable	<u>(0.4)</u>
	<u>(6.2)</u>

The decrease in trade accounts payable was mainly related to lower payables for inventory purchases payable and a lower volume of expense activity at January 31, 2007 compared to October 31, 2006. The decrease in accrued liabilities was largely related to a reduction in accrued bonuses, vacation pay and dividends.

Income taxes payable decreased by \$2.6 million or 70.6%, due to taxes payable of \$3.8 million at October 31, 2006 that were related to a parcel of land sold in 2003 subject to a mortgage receivable and which were paid in the first quarter of 2007. The reduction in taxes payable due to payment of the \$3.8 million was partially offset by net 2007 taxes payable, representing the difference between accrued taxes for the quarter and tax instalments paid in the quarter, which were based on 2006 earnings.

Deferred revenue at January 31, 2007 increased by \$1.7 million or 1.0% from October 31, 2006 to \$177.7 million. Of the \$1.7 million, \$1.4 million was due to a fair value adjustment recorded as a result of the implementation of new accounting standards for financial instruments.

Deferred revenue at January 31, 2007 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 \$689.2 million compared to \$670.1 at October 31, 2006, an increase of \$19.1 million or 2.9%. Of the \$19.1 million increase, \$10.2 million was a fair value adjustment to pre-need trust funds that was recorded as a result of the implementation of new accounting standards for financial instruments. The remaining increase was \$8.9 million or 1.3% (first quarter of 2006 - \$7.0 million or 1.1%) and represented deferral of revenue in the period in excess of amounts recognized upon delivery of merchandise and services.

Non-controlling interests in pre-need funds increased by \$11.8 million or 2.9% to \$416.2 million. Of the \$11.8 million, \$8.8 million was due to a fair value adjustment recorded as a result of the implementation of new accounting standards for financial instruments in the first quarter of 2007. The remaining increase of \$3.0 million was due to higher deferred merchandise and services contracts written compared to the amount of merchandise and services delivered to customers in the period.

Other liabilities increased by \$0.9 million or 8.8%. Of the \$0.9 million increase:

- \$0.6 million represented the fair value of the interest rate swap agreements that was recorded in the period as a result of the implementation of new accounting standards for financial instruments;
- \$0.2 million was due to an increase in GST and HST payable; and
- \$0.1 million was related to other items.

Non-controlling interests in cemetery care funds increased by \$9.0 million or 5.8% in the first quarter of 2007, of which \$5.7 million was due to a fair value adjustment as a result of the implementation of new accounting

standards for financial instruments. Excluding the fair value adjustment, non-controlling interests in cemetery care funds increased by \$3.3 million or 2.1% due to deposits to the funds as a result of at-need and pre-need cemetery interment right sales.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Net cash used for operating activities of continuing operations improved by \$2.2 million or 57.9% from the first quarter of 2006 to the first quarter of 2007 due to:

- higher net earnings of \$1.0 million;
- a smaller reduction in the net future income tax liability of \$0.7 million;
- a lower negative net change in other operating balance sheet items of \$0.4 million; and
- \$0.1 million of other changes.

Net cash used for investing activities of continuing operations improved by \$25.6 million or 76.0% mainly due to the acquisition of seven funeral homes in the first quarter of 2006 for \$24.0 million and lower additions to fixed assets of \$1.4 million. Fixed asset additions in the first quarter of 2006 were higher than the first quarter of 2007 mainly due to increased spending on reception centres of \$0.7 million and \$0.4 million spent on the renovation of an existing funeral home in Edmonton, Alberta.

Net cash provided by financing activities of continuing operations decreased by \$19.5 million or 78.3% in the first quarter of 2007 compared to the first quarter of 2006 mainly due to new debt of \$19.9 million borrowed in the first quarter of 2006 to partially finance the acquisition of seven funeral homes

UNAUDITED QUARTERLY RESULTS

	Four Fiscal Quarters Ended January 31, 2007			
	<u>Apr-30</u>	<u>Jul-31</u>	<u>Oct-31</u>	<u>Jan-31</u>
Revenue (\$millions) ⁽¹⁾	55.7	53.4	55.7	55.3
Net earnings (\$millions) ⁽²⁾	6.4	4.2	4.2	5.4
Basic and diluted earnings per share (\$) ⁽³⁾	0.61	0.39	0.39	0.51

	Four Fiscal Quarters Ended January 31, 2006			
	<u>Apr-30</u>	<u>Jul-31</u>	<u>Oct-31</u>	<u>Jan-31</u>
Revenue (\$millions) ⁽¹⁾	51.3	48.5	50.8	50.7
Net earnings (\$millions) ⁽²⁾	5.7	3.1	4.2	4.4
Basic and diluted earnings per share (\$) ⁽³⁾	0.54	0.30	0.38	0.42

Prepared in accordance with GAAP. All amount are in Canadian dollars.

- (1) Revenue for the last three quarters of 2005 and the first three quarters of 2006 were restated to conform to the presentation at January 31, 2007 and October 31, 2006 (see note 9 to the financial statements).
- (2) Net earnings from continuing operations do not differ significantly from net earnings.
- (3) 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

Revenue in the first quarter of 2006 through to the first quarter of 2007 was affected by new operations, particularly seven funeral homes in the Ottawa, Ontario area that were acquired in the first quarter of 2006. New operations in those quarters contributed the following to sales (in \$millions):

First quarter 2006	\$1.9
Second quarter 2006	\$2.1
Third quarter 2006	\$2.5
Fourth quarter 2006	\$2.6
First quarter 2007	\$2.7

Revenue in the second quarter of 2006 was also affected by an increase in the delivery of at-need cemetery merchandise and services of \$1.2 million, of which \$0.5 million was related to an administrative project.

Revenue in the third quarter of 2006 and the third quarter of 2005 was the lowest of the comparable quarters due to seasonality.

Revenue in the second quarter of 2005 was higher than the last two quarters of 2005 and the first quarter of 2006 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.

Net Earnings and Earnings Per Share

Net earnings and earnings per share in the fourth quarter of 2006 were negatively affected by an increase in provisions for cancellation of pre-need merchandise and services of \$0.9 million after income taxes and \$0.6 million in impairment provisions after income taxes.

Net earnings and earnings per share in the third quarter of 2006 and the third quarter of 2005 were low as a result of the lower revenues.

Net earnings and earnings per share in the second quarter of 2006 were higher due to the improvement in sales in both the cemetery and funeral divisions.

Net earnings and earnings per share in the fourth quarter of 2005 were affected by a provision of \$0.5 million after income taxes for settlement of pre-need liabilities of sold cemeteries.

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.

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 March 1, 2007, 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.

CAPITAL EXPENDITURES AND CEMETERY BURIAL SPACE INVENTORY

At January 31, 2007, the Company had only one project on which significant funds had been expended prior to January 31, 2007 but that had not yet generated operating revenue as follows:

Greenlawn Memorial Gardens/Victoria Memorial Gardens – Reception Centre: as at January 31, 2007, the Company had spent \$0.9 million on this project. The Company estimates that an additional \$6.5 million will be spent to complete this project and anticipates completing the project in the first quarter of fiscal 2008.

The Company had committed to the following expenditures for capital and cemetery burial space inventory at January 31, 2007 (in \$millions):

Reception centre	3.0
Cemetery burial space inventory	1.1
Cemetery maintenance capital expenditures	0.9
Funeral casket inventory	10.0
	<u>15.0</u>

The Company anticipates funding these expenditures from existing cash and cash from operations generated in 2007.

Following is the Company's planned capital and cemetery burial space inventory spending for the remainder of fiscal 2007 (in \$millions):

Maintenance capital expenditures	\$12.1
New initiatives	9.9
Cemetery burial space inventory	<u>5.8</u>
	<u>\$27.8</u>

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

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.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

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

March 1, 2007

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED STATEMENTS OF EARNINGS

Three Months Ended January 31 (\$000)	2007	2006⁽¹⁾
Revenue		
Sales	51,601	47,220
Investment and other income (note 5)	3,737	3,500
	55,338	50,720
Expenses		
Operating	42,276	39,494
Corporate	3,524	3,481
	45,800	42,975
Earnings before interest expense and income taxes	9,538	7,745
Interest expense	1,237	1,190
Earnings before income taxes	8,301	6,555
Income taxes (note 8)	2,864	2,148
Net earnings from continuing operations	5,437	4,407
Net (loss) earnings from discontinued operations (note 9)	(26)	23
Net earnings	5,411	4,430
Weighted average number of shares outstanding (in thousands)	10,595	10,595
Earnings per share - basic and diluted (in \$)		
Earnings per share from continuing operations	0.51	0.42
Earnings per share from discontinued operations	-	-
	0.51	0.42

(1) Certain figures provided for January 31, 2006 have been reclassified to conform with the current period's presentation - see note 9.

UNAUDITED CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Three Months Ended January 31 (\$000)	2007	2006
Retained earnings, beginning of period	118,886	100,462
Net earnings for the period	5,411	4,430
Retained earnings, end of period	124,297	104,892

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

<i>Three Months Ended January 31 (\$000)</i>	<i>2007</i>
Net earnings	5,411
Other comprehensive income:	
Net change in losses on derivatives designated as cash flow hedges (note 6)	
Reduction in losses on derivatives designated as cash flow hedges	259
Income taxes on reduction in losses on derivatives designated as cash flow hedges	(93)
	166
Net change in unrealized gains associated with available for sale securities of the pre-need trust funds (note 3)	
Change in unrealized gains associated with available for sale securities of the pre-need trust funds, net of income taxes of \$246	454
Reclassification of net change in unrealized gains associated with available for sale securities of the pre-need trust funds to non-controlling interests and deferred revenue, net of income taxes of \$246	(454)
	-
Net change in unrealized gains associated with available for sale securities of the cemetery care funds (note 4)	
Change in unrealized gains associated with available for sale securities of the cemetery care funds, net of income taxes of \$168	(309)
Reclassification of change in unrealized gains associated with available for sale securities of the cemetery care funds to non-controlling interests, net of income taxes of \$168	309
	-
Other comprehensive income	166
Comprehensive income	5,577

UNAUDITED CONSOLIDATED STATEMENT OF ACCUMULATED OTHER COMPREHENSIVE LOSS

<i>Three Months Ended January 31 (\$000)</i>	<i>2007</i>
Accumulated other comprehensive income, beginning of period as previously reported	-
Transition adjustment for cash flow hedges, net of income taxes of \$314	(555)
Accumulated other comprehensive loss, beginning of period as restated	(555)
Other comprehensive income for the period	166
Accumulated other comprehensive loss, end of period	(389)

Arbor Memorial Services Inc.
UNAUDITED CONSOLIDATED BALANCE SHEETS

<i>In \$000</i>	<i>As at</i>	
	<i>January 31</i>	<i>October 31</i>
	<i>2007</i>	<i>2006</i>
Assets		
Current assets		
Cash	7,599	11,857
Accounts receivable	23,143	20,054
Merchandise inventories	9,575	9,663
Prepaid expenses	1,149	947
Mortgage receivable, current portion	6,750	6,750
Future income taxes, current portion (note 8)	240	220
Pre-need receivables, current portion (note 3)	38,412	39,309
	86,868	88,800
Pre-need receivables and funds (note 3)	455,009	441,721
Cemetery care funds (note 4)	165,314	156,310
Crypts and niches	22,959	24,077
Cemetery land	35,632	35,583
Fixed assets	182,934	183,834
Goodwill	54,502	54,502
Mortgage receivable	6,750	6,750
Deferred obtaining costs and stored merchandise	70,734	69,846
Future income taxes (note 8)	4,974	4,777
Assets related to discontinued operations (note 9)	1,246	1,246
Intangible and other assets	2,890	2,766
	1,089,812	1,070,212
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	20,079	26,242
Income taxes payable	1,094	3,717
Future income taxes, current portion (note 8)	2,627	2,490
Long-term debt, current portion	4,045	2,701
	27,845	35,150
Deferred revenue	177,729	176,035
Non-controlling interests in pre-need funds	416,249	404,483
Long-term debt	88,195	89,713
Future income taxes (note 8)	6,501	6,500
Other liabilities	11,572	10,636
	728,091	722,517
Non-controlling interests in cemetery care funds	165,314	156,310
Shareholders' equity		
Share capital (note 7)	72,499	72,499
Retained earnings	124,297	118,886
Accumulated other comprehensive loss	(389)	-
	196,407	191,385
	1,089,812	1,070,212

Arbor Memorial Services Inc.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

Three Months Ended January 31 (\$000)	2007	2006 ⁽¹⁾
Cash provided by (used for)		
Operating activities		
Net earnings	5,411	4,430
Add (deduct) net loss (earnings) from discontinued operations (note 9)	26	(23)
Add (deduct) items not affecting cash from operating activities:		
Depreciation and amortization	2,528	2,423
Gain on disposal of assets	(4)	(14)
Future income taxes (note 8)	142	(813)
Developed land, crypt and niche cost of sales	2,145	2,035
Additions to developed land, crypts and niches	(1,039)	(830)
Net change in other operating balance sheet items (note 11)	(10,784)	(10,947)
Net cash used for continuing operations	(1,575)	(3,739)
Net cash (used for) provided by discontinued operations	(26)	36
Investing activities		
Additions to fixed assets	(1,614)	(2,975)
Acquisition	-	(23,981)
Additions to cemetery land held for future development	(37)	(6)
Proceeds on disposal of assets	5	14
Change in pre-need funds	(3,076)	(3,949)
Change in cemetery care funds	(3,344)	(2,730)
Net cash used for continuing operations	(8,066)	(33,627)
Net cash provided by discontinued operations	-	7
Financing activities		
Proceeds from new long-term debt	-	19,942
Repayment of long-term debt	(174)	(3)
Dividends	(742)	(742)
Change in non-controlling interests in pre-need funds	2,981	3,003
Change in non-controlling interests in cemetery care funds	3,344	2,730
Net cash provided by continuing operations	5,409	24,930
Net cash used for discontinued operations	-	(7)
Decrease in cash	(4,258)	(12,400)
Cash, beginning of period	11,857	10,954
Cash (bank indebtedness), end of period	7,599	(1,446)
Supplementary information		
Income taxes paid	5,426	2,856
Interest paid	1,228	1,138

⁽¹⁾ Certain figures provided for January 31, 2006 have been reclassified to conform with the current period's presentation - see note 9.

ARBOR MEMORIAL SERVICES INC.
UNAUDITED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Three Months Ended January 31, 2007 and 2006

1. BASIS OF PRESENTATION

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 2006 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 2006 annual consolidated financial statements.

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

2. NEW ACCOUNTING POLICIES

In 2005, the Canadian Institute of Chartered Accountants ("CICA") issued new accounting standards concerning financial instruments: Financial Instruments – Recognition and Measurement ("Section 3855"); Hedges ("Section 3865"); and Comprehensive Income ("Section 1530"). The standards require prospective application and are effective for the Company's first quarter of fiscal 2007.

Section 1530 introduces the concept of comprehensive income, which consists of net income and other comprehensive income (loss) ("OCI"), and represents changes in Shareholders' equity during a period arising from transactions with non-owners. OCI includes among its components, unrealized gains and losses on financial assets classified as "available for sale" and changes in the fair value of the effective portion of cash flow hedging instruments together with income tax expenses or benefits associated with each component. As a result of the implementation of this section, the Consolidated Financial Statements include a Consolidated Statement of Comprehensive Income, while the cumulative amount of OCI, which is termed "accumulated other comprehensive loss" or "AOCL", is presented as a new category of shareholders' equity in the Consolidated Balance Sheets.

Section 3855 establishes standards for recognizing and measuring financial instruments. On application of Section 3855, the Company classified the investments in the pre-need cemetery and funeral trust funds and the investments in the cemetery care funds as "available for sale" and changed the basis of measurement for these assets from cost to fair value in the Consolidated Balance Sheets. Unrealized gains and losses on these "available for sale" financial assets are excluded from net earnings and initially recorded net of income taxes as a component of OCI in the Consolidated Statement of Comprehensive Income. The Company then reclassifies the unrealized gains and losses of the trust funds to the non-controlling interests in pre-need funds, the non-controlling interests in cemetery care funds or deferred revenue, as appropriate, as such unrealized earnings have not been earned by the Company through the performance of services or delivery of merchandise. The Company continues to recognize as sales, amounts removed from the pre-need funds upon the performance of services and delivery of merchandise, including realized earnings accumulated in the funds. As a result of the reclassification, the Company's AOCL is ultimately not affected by the adoption of Section 3855.

All other financial assets and financial liabilities are classified and measured as follows:

<u>Asset/Liability</u>	<u>Classification</u>	<u>Measurement</u>
Accounts receivable	Loans and receivables	Amortized cost
Instalment accounts receivable	Loans and receivables	Amortized cost
Mortgage receivable	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Long-term debt	Other liabilities	Amortized cost

Section 3865 establishes standards for when and how hedge accounting may be applied. The Company's derivative financial instruments, which consist of interest rate swap agreements that have been designated as cash flow hedges, have been reported at fair value as a result of the implementation of Section 3855 and Section 3865. The unrealized gains and losses that arise as a result of remeasuring the swap agreements at their fair value at the end of each period are recognized, net of income taxes, in OCI. To date, there has not been any ineffectiveness in these cash flow hedges.

Section 3855 requires that interest income and expense be allocated over the relevant period using the effective interest method (EIM). Under the EIM, interest income and expense is calculated and recorded using an effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the initial net carrying amount of the financial asset or liability. Transaction costs that are directly attributable to the acquisition or issue of financial instruments classified as other than "held for trading" are included in the initial carrying value of such instruments and amortized using the EIM. As a result of implementing this Section, the Company has recorded the interest income and expense related to all financial assets and liabilities using the EIM.

In accordance with Section 3855, the Company conducted a search for embedded derivatives in all contractual arrangements dated subsequent to October 31, 2002 and did not identify any embedded features that required separate presentation from the related host contract.

3. PRE-NEED RECEIVABLES AND FUNDS

	<u>January 31</u> <u>2007</u>	<u>October 31</u> <u>2006</u>
	(\$000)	
Cemetery trust funds	191,856	184,332
Funeral trust funds	<u>207,872</u>	<u>201,798</u>
	399,728	386,130
Instalment accounts receivable	67,600	68,493
Pre-need group annuity funds	<u>26,093</u>	<u>26,407</u>
	493,421	481,030
Less: current portion of instalment accounts receivable	<u>38,412</u>	<u>39,309</u>
	<u>455,009</u>	<u>441,721</u>

As a result of the implementation of Section 3855 of the CICA Handbook as described in Note 2, the cemetery and funeral trust funds were measured at fair value at November 1, 2006 and the resulting unrealized net gain of \$9.5 million was initially recorded to "Other comprehensive income", net of income taxes of \$3.3 million, and subsequently reclassified to either "Non-controlling interests in pre-need funds" or "Deferred revenue". The funds were then remeasured at fair value at January 31, 2007 and the increase in the fair value of \$0.7 million was initially recorded to "Other comprehensive income", net of income taxes of \$0.2 million, and subsequently reclassified to either "Non-controlling interests in pre-need funds" or "Deferred revenue". In accordance with the Section, however, the prior period comparative figures at October 31, 2006 were not restated to fair value and are therefore presented at book value.

The funds consist of investments with fixed and floating interest rates, equity securities and an equity fund as follows:

	<u>Book Value</u>		<u>Fair Value</u>	
	<u>January 31</u> <u>2007</u>	<u>October 31</u> <u>2006</u>	<u>January 31</u> <u>2007</u>	<u>October 31</u> <u>2006</u>
	(\$000)		(\$000)	
Cash	4,531	7,691	4,531	7,691
Term deposits	229,964	228,572	229,909	228,575
Bonds	125,427	120,763	127,780	124,117
Equities	17,177	16,683	25,035	23,084
Equity fund	<u>12,421</u>	<u>12,421</u>	<u>12,473</u>	<u>12,171</u>
	<u>389,520</u>	<u>386,130</u>	<u>399,728</u>	<u>395,638</u>

The consolidated balance sheets do not include pre-need funeral and cemetery contracts that will be funded by third-party insurers under group annuity programs, upon delivery of pre-need merchandise and services, where the Company is not the policyholder. At January 31, 2007, the accumulated benefit of all such contracts was \$95.2 million (October 31, 2006 - \$89.6 million).

4. CEMETERY CARE FUNDS

As a result of the implementation of Section 3855 of the CICA Handbook as described in Note 2, the cemetery care funds were measured at fair value at November 1, 2006 and the resulting unrealized net gain of \$6.1 million was initially recorded to "Other comprehensive income", net of income taxes of \$2.2 million, and subsequently reclassified to "Non-controlling interests in cemetery care funds". The funds were then remeasured at fair value at January 31, 2007 and the decrease in the fair value of \$0.5 million was initially recorded to "Other comprehensive income", net of income taxes of \$0.2 million, to "Non-controlling interests in cemetery care funds". In accordance with the Section, however, the prior period comparative figures at October 31, 2006 were not restated to fair value and are therefore presented at book value.

Cemetery care funds consist of investments with fixed and floating interest rates, a mortgage fund and equity securities as follows:

	<i>Book Value</i>		<i>Fair Value</i>	
	<i>January 31</i>	<i>October 31</i>	<i>January 31</i>	<i>October 31</i>
	<i>2007</i>	<i>2006</i>	<i>2007</i>	<i>2006</i>
	(\$000)		(\$000)	
Cash and term deposits	9,452	8,953	9,452	8,953
Bonds	137,189	134,486	139,216	137,411
Mortgage fund	150	152	150	152
Equities	12,863	12,719	16,496	15,931
	159,654	156,310	165,314	162,447

5. INVESTMENT AND OTHER INCOME

	<i>Three Months Ended January 31</i>									
	<i>Cemetery</i>		<i>Funeral</i>		<i>Care Funds</i>		<i>Other</i>		<i>Consolidated</i>	
	<i>2007</i>	<i>2006</i>	<i>2007</i>	<i>2006</i>	<i>2007</i>	<i>2006</i>	<i>2007</i>	<i>2006</i>	<i>2007</i>	<i>2006</i>
	(\$000)									
Realized earnings of funds:										
Interest and dividends	1,530	1,417	2,494	2,551	1,994	1,919	-	-	6,018	5,887
Realized gains	1	183	3	582	6	3	-	-	10	768
Realized losses	(9)	(1)	(10)	(138)	(2)	(14)	-	-	(21)	(153)
Trust expenses	(39)	(37)	(35)	(34)	(70)	(67)	-	-	(144)	(138)
	1,483	1,562	2,452	2,961	1,928	1,841	-	-	5,863	6,364
Deferred revenue	(12)	(17)	-	-	-	-	-	-	(12)	(17)
Non-controlling interests in funds	(1,471)	(1,545)	(2,452)	(2,961)	47	61	-	-	(3,876)	(4,445)
	-	-	-	-	1,975	1,902	-	-	1,975	1,902
Fee income	409	441	1,110	970	-	-	-	-	1,519	1,411
Other	-	-	-	-	-	-	243	187	243	187
	409	441	1,110	970	1,975	1,902	243	187	3,737	3,500

6. DERIVATIVE FINANCIAL INSTRUMENTS

As of January 31, 2007, the Company's use of derivative financial instruments was limited to seven (October 31, 2006 – seven) interest rate swap agreements with a Canadian chartered bank. Total debt under swap contracts at the end of the period was \$42.0 million (October 31, 2006 - \$43.8 million) and the estimated fair value of the interest rate swaps at January 31, 2007 was a loss of \$0.6 million (October 31, 2006 – loss of \$0.9

million), which was recorded in "Other liabilities". The reduction in the loss in the period of \$0.3 million has been recorded, net of income taxes, in "Other comprehensive income" (see note 2). The accumulated loss at November 1, 2006 of \$0.9 million was recorded, net of income taxes of \$0.3 million, as a transition adjustment to opening "Accumulated other comprehensive loss".

Total swaps and other fixed rate debt represented 48% (October 31, 2006 – 49%) of the total amount of long-term debt outstanding. Swap costs for the first quarter of 2007 were \$0.1 million (first quarter of 2006 - \$0.3 million).

7. SHARE CAPITAL

Issued and outstanding:

		<u>January 31</u>	<u>October 31</u>
		<u>2007</u>	<u>2006</u>
		(\$000)	
Number of Shares			
2,525,497	Class A Shares	1,734	1,734
<u>8,069,746</u>	Class B Shares	<u>70,765</u>	<u>70,765</u>
<u><u>10,595,243</u></u>		<u><u>72,499</u></u>	<u><u>72,499</u></u>

The weighted-average exercise price of share purchase options that were issued, outstanding and exercisable at January 31, 2007 was \$23.50 (October 31, 2006 - \$25.07) and the weighted-average remaining contractual life was 0.9 years (October 31, 2006 – 0.9 years). During the three months ended January 31, 2007, 45,000 options expired (three months ended January 31, 2006 – nil options).

8. INCOME TAXES

Income tax expense

Income tax expense for the three months ended January 31 consisted of the following:

	<u>January 31</u>	<u>January 31</u>
	<u>2007</u>	<u>2006</u>
	(\$000)	
Current tax expense	2,722	2,961
Future income tax expense (benefit) relating to the origination and reversal of temporary differences	142	(813)
Income tax expense	<u><u>2,864</u></u>	<u><u>2,148</u></u>

Effective income tax rate

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

	<u>January 31</u>	<u>January 31</u>
	<u>2007</u>	<u>2006</u>
	%	%
Combined basic federal and provincial income tax rate	34.2	34.4
Increase (decrease) in the basic tax rate resulting from:		
Dividends/RDTOH	(0.8)	(1.0)
Impact of future income tax changes on effective tax rate	0.6	(0.5)
Meals and entertainment	0.4	0.5
Non-taxable portion of capital gains	-	(1.5)
Large corporations tax	-	0.4
Other items	0.1	0.5
Effective income tax rate	<u><u>34.5</u></u>	<u><u>32.8</u></u>

In the first quarter of 2007, the Company recognized current and long-term amounts for both assets and liabilities of individual corporate entities and reclassified the balance sheet at October 31, 2006 accordingly.

The Company has \$3.4 million in unrecognized capital losses, the benefit of which is unlikely to be realized.

9. DISCONTINUED OPERATIONS

In 2005, the assets of a funeral branch operation met the criteria for being classified as a discontinued operation. The sale of this operation was completed in the fourth quarter of 2006. In the fourth quarter of 2006, the assets of two additional branches met the criteria for being classified as discontinued operations.

Revenue associated with discontinued operations in the first three months of 2007 was \$0.1 million (2006 – \$0.3 million). Net loss in the first three months of 2007 was less than \$0.1 million (2006 – net earnings less than \$0.1 million). The prior year comparative amounts in the statements of earnings and the statements of cash flows have been reclassified for the two funeral branches identified as discontinued operations in the fourth quarter of 2006.

10. CONTRACTUAL COMMITMENTS

At January 31, 2007, the Company was contractually committed to capital and cemetery burial space inventory expenditures of \$5.0 million (October 31, 2006 - \$2.0 million). The Company is also contractually committed to funeral inventory purchases of \$15.5 million, during the period 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 will be extended. From February 1, 2006 to January 31, 2007, the Company had purchased \$5.5 million under this commitment.

11. NET CHANGE IN OTHER OPERATING BALANCE SHEET ITEMS

	<u>January 31</u> <u>2007</u>	<u>January 31</u> <u>2006</u>
	(\$000)	
Accounts receivable	(3,089)	(1,422)
Prepaid expenses	(202)	(553)
Instalment accounts receivable	893	261
Deferred obtaining costs and stored merchandise	(888)	(482)
Accounts payable and accrued liabilities	(5,421)	(8,489)
Income taxes payable	(2,623)	220
Deferred revenue	271	(151)
Other liabilities	326	(7)
Other changes	(51)	(324)
	<u>(10,784)</u>	<u>(10,947)</u>

12. SEGMENT DISCLOSURE

Industry segments (\$000)

	<i>Three Months Ended January 31</i>							
	<i>Cemetery</i>		<i>Funeral</i>		<i>Corporate</i>		<i>Consolidated</i>	
	<i>2007</i>	<i>2006</i>	<i>2007</i>	<i>2006</i>	<i>2007</i>	<i>2006</i>	<i>2007</i>	<i>2006</i>
Sales ⁽¹⁾	21,953	21,041	29,506	26,031	142	148	51,601	47,220
Investment and other income ⁽¹⁾	2,384	2,343	1,110	970	243	187	3,737	3,500
Revenue	24,337	23,384	30,616	27,001	385	335	55,338	50,720
Depreciation and amortization ⁽¹⁾	841	779	1,328	1,274	359	370	2,528	2,423
Earnings (loss) before interest expense and income taxes ⁽¹⁾	2,900	3,133	9,777	7,758	(3,139)	(3,146)	9,538	7,745
Interest expense	-	-	-	-	1,237	1,190	1,237	1,190
Earnings (loss) before income taxes ⁽¹⁾	2,900	3,133	9,777	7,758	(4,376)	(4,336)	8,301	6,555
Identifiable assets ⁽²⁾	587,045	573,465	468,319	462,655	34,448	34,092	1,089,812	1,070,212
Capital expenditures	1,061	2,336	485	482	68	157	1,614	2,975
Developed land, crypt and niche additions	1,039	830	-	-	-	-	1,039	830
Cemetery land held for future development additions	37	6	-	-	-	-	37	6
Pre-need contracts written	16,472	15,417	12,020	10,470	-	-	28,492	25,887

⁽¹⁾ Figures provided for 2006 have been reclassified to conform with the current year's presentation - see note 9.

⁽²⁾ Identifiable assets shown for 2006 are as at October 31.

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