

First Quarter Report

**Three Months Ended
January 31, 2006**



**ARBOR
MEMORIAL
SERVICES INC.**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis has been prepared for the three months ended January 31, 2006 and includes material information available up to March 2, 2006. The financial data provided has been prepared in accordance with Canadian generally accepted accounting principles and all figures provided are in Canadian dollars. Management's Discussion and Analysis herewith provided is the responsibility of the Company's management. The Board of Directors is responsible for reviewing and approving Management's Discussion and Analysis. Additional information relating to Arbor Memorial Services Inc., including the Company's 2005 Annual Information Form and the 2005 Annual Report, can be found on SEDAR at www.sedar.com.

Certain statements contained in this Management's Discussion and Analysis, including, but not limited to, information regarding the status and progress of the Company's operating and capital activities, the plans and objectives of the Company and assumptions regarding the Company's future performance, are forward-looking statements. Forward-looking statements may include words such as "believes", "may", "should", "estimates", "continues", "indicates", "suggests", "anticipates", "intends", "plans", "expects" and similar expressions. These forward-looking statements are based on current expectations and various factors and assumptions. Accordingly, these forward-looking statements are subject to certain risks and uncertainties. The material factors and assumptions that were applied in making the forward-looking statements in this Management's Discussion and Analysis include, but are not limited to: reliance on third-party reports from government bodies and industry associations, the use of economic forecasts prepared by various financial institutions, historical experience, and financial reporting of competitors and suppliers. Risks and uncertainties that could cause or contribute to such differences include, but are not limited to, those discussed elsewhere in this First Quarter Report, those discussed under "Risks, Events and Uncertainties" in the Company's 2005 Annual Report and in the Company's 2005 Annual Information Form under "Description of the Business – Risk Factors". The Company cannot provide any assurance that forward-looking statements will materialize. The Company assumes no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

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

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

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

TOTAL COMPANY RESULTS

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

	2006		2005	
	<i>\$Millions</i>	<i>% of Total</i>	<i>\$Millions</i>	<i>% of Total</i>
Sales				
Cemetery	21.0	41.3	20.6	42.8
Funeral	26.1	51.4	23.8	49.5
Corporate	0.2	0.4	0.2	0.4
	47.3	93.1	44.6	92.7
Investment and other income	3.5	6.9	3.5	7.3
	50.8	100.0	48.1	100.0

Revenue for the quarter ended January 31, 2006 was \$50.8 million. This represented a \$2.7 million or 5.6% increase over the first quarter of 2005. Almost all of the increase was in sales, while investment and other income decreased marginally to \$3.5 million.

Sales in the cemetery division increased by \$0.4 million or 2.0%, while sales in the funeral division increased by \$2.3 million or 9.8%. Of the \$2.3 million increase in the funeral division, \$2.2 million was related to new operations. Sales of existing operations in the funeral division increased by 0.5 of a percentage point, which was the net impact of an increase of 2.7% in the average sale per funeral service and a decrease of 2.2% in the number of services. The cemetery division experienced a decrease in the number of at-need interments of 4.5%.

Investment and other income in the first quarter of 2006 decreased marginally due to a reduction in the fees received under the pre-need funeral annuity and trust programs. Income earned on the cemetery care funds and fees received under the cemetery trust program increased by 1.7% and 5.0% respectively.

Operating expenses increased by \$2.6 million or 6.9% to \$39.6 million in the first quarter of 2006 compared to the same period in 2005. Cemetery division expenses increased by \$0.1 million or 0.7% due mainly to increases in selling and care and maintenance expenses. Funeral division expenses increased by \$2.4 million or 14.3%, of which \$1.8 million was related to new operations.

General and administrative expenses increased by \$0.3 million or 9.3% to \$3.5 million, of which \$0.2 million was due to an increase in depreciation expense as a result of the implementation of a new operating system in 2005.

Earnings before interest expense and income taxes were \$7.7 million, which represented a decrease of \$0.1 million or 1.9% compared to 2005. The decrease was attributable to an increase in operating costs of existing operations and an increase in general and administrative costs that exceeded the increase in sales. The decrease in investment and other income also had an impact.

Interest expense included interest on floating-rate bank term debt, a capital lease and the cost of the Company's interest rate swap contracts. Interest expense increased by \$0.2 million or 16.3% to \$1.2 million in the first quarter of 2006 due to new floating-rate bank term debt of \$19.9 million that was borrowed at the beginning of the quarter to finance the acquisition of 7 funeral homes. The average long-term debt balance increased by \$19.1 million or 24.6%.

With respect to swap costs, since actual floating interest rates before bank margins averaged 4.0% (2005 – 3.7%) during the quarter, the swaps caused the Company's interest expense to be higher in 2006 by \$0.3 million (2005 - \$0.4 million) than would otherwise have been the case if the Company had maintained all floating-rate debt. The weighted average rate of interest on long-term debt for the quarter was 4.9% compared to 5.3% in 2005. The reduction in the weighted average rate was due to a lower proportion of fixed debt in 2006 compared to 2005. Excluding swap costs, the weighted average rate was 3.9% compared to 3.4% in 2005, due to higher rates of floating-rate bank term debt and higher rates of interest on amounts drawn on the lines of credit. The proportion of fixed-rate debt at January 31, 2006, including swap contracts, was 51% compared to 66% at October 31, 2005.

Income taxes for the first quarter of 2006 resulted in an effective tax rate of 32.8%, compared to 34.1% in the first quarter of 2005. The 1.3% decrease in the rate was due to a higher amount of capital gains recognized in the period that are taxed at a lower rate, a higher dividend refund and a lower large corporations tax due to a lower rate and a higher surtax paid.

Net earnings and earnings per share in the quarter were \$4.4 million and \$0.42 compared to \$4.5 million and \$0.43 per share in 2005. The decrease was attributable to an increase in expenses that exceeded the increase in revenue.

CEMETERY DIVISION

Cemetery sales in the first quarter of 2006 increased by \$0.4 million or 2.0% over the first quarter of 2005 to \$21.0 million. Sales in the quarter, including finance charges and net of cancellation allowances, consisted of:

- \$7.2 million (2005 - \$7.3 million) of pre-need sales of interment rights;
- \$6.4 million (2005 - \$5.6 million) of pre-need sales of merchandise and services, recognized at the point when merchandise was delivered or services were performed, including income earned on related pre-need trust funds;
- \$7.4 million (2005 - \$7.7 million) of at-need sales of interment rights and deliveries of at-need merchandise and services.

Following is a breakdown of the \$0.4 million increase in total cemetery sales (in \$millions):

<u>At-Need</u>	
Interment rights	(0.2)
Merchandise	(0.2)
Services	<u>0.1</u>
	<u>(0.3)</u>
<u>Pre-Need</u>	
Interment rights	(0.1)
Merchandise	0.8
Services	<u>-</u>
	<u>0.7</u>
	<u>0.4</u>

The \$0.8 million increase in pre-need merchandise sales was due to an increase in the delivery of bronze memorials and upright monuments in the period. This increase was timing related. The \$0.3 million decrease in at-need sales was the result of a reduction in the number of interments in the period. The Company believes that this is a temporary reduction due to a lower number of deaths across the country.

Pre-need cemetery sales contracts written in the quarter were \$15.4 million, compared to \$15.2 million in 2005. This represented an increase of \$0.2 million or 1.3%. While pre-need merchandise and services contracts and certain interment right contracts that do not meet minimum deposit requirements are not included immediately in the Company's reported sales, they do contribute to building future market share and future reported sales.

In the first quarter of 2006, the number of interments performed by the Company decreased by 4.5% to 3,910 and the number of cremations increased by 3.6% to 3,673. This compared to increases in interments in each of fiscal 2005 and 2004 of 0.2% and 2.4% and increases in cremations of 0.2% and 1.7% respectively on a comparable basis.

Cemetery investment income increased by \$0.1 million or 2.3% over the first quarter of 2005 to \$2.3 million due to increases in both care fund income and the fees received from the deposit of pre-need cemetery funds.

Interest and dividend income earned on the care funds increased by 1.7% due to a higher average balance in the funds of \$10.5 million or 7.7% and despite a decrease in the annualized average rate of return on the funds from 5.6% in the first quarter of 2005 to 5.2% in 2006. Similarly, interest and dividend income on pre-need cemetery merchandise and services trust funds earned in the year increased by \$0.1 million or 6.6% due to a higher average balance in the funds of \$14.4 million or 9.0%. The impact of the higher balance was partially offset by a lower annualized average rate of return on the funds from 4.4% in 2005 to 4.3% in 2006. While interest and dividend income on the care funds is recognized as earned in order to defray cemetery care and maintenance costs, interest and dividend income earned on the pre-need trust funds is deferred and recognized as sales revenue when the underlying merchandise is delivered or the service is performed.

Cemetery expenses for the quarter increased by \$0.1 million or 0.7% as follows (in millions):

Cost of sales	(0.5)
Selling	0.3
Care and maintenance	0.3
Other	<u>-</u>
	<u>0.1</u>

The decrease in cost of sales expense of \$0.5 million, despite a \$0.4 million increase in sales, was due to a \$0.3 million change in the estimate of the cost of providing monument death date inscriptions to pre-need customers and a change in the mix of sales. In particular, sales of pre-need burial spaces, which have the highest cost of sales percentage, were lower than 2005 by 2.0% and sales of pre-need merchandise were higher than 2005 by 17.7%.

The \$0.3 million or 6.6% increase in selling expenses was due to higher employee costs and managerial commissions as well as timing of marketing expenses, among other items. The \$0.3 million or 7.4% increase in care and maintenance expenses was driven by higher employee, fuel and utility costs. The increase in employee costs was partially due to regular annual increases but also due to a higher incidence of short-term sick leave, which is self-financed by the Company.

Earnings before interest expense and income taxes in the cemetery division increased by \$0.3 million or 11.6% in the first quarter of 2006 compared to 2005 due mainly to the increase in sales and the reduction in cost of sales.

FUNERAL DIVISION

Funeral sales in the first quarter of 2006 increased by \$2.3 million or 9.8% over the first quarter of 2005 to \$26.1 million. The improvement was attributable to a \$2.2 million increase in sales of new operations and a \$0.1 million or 0.5% increase in sales of existing operations. New operations in the quarter included 7 funeral homes in the Ottawa, Ontario area that were acquired at the beginning of the quarter and a new funeral home in Markham, Ontario that opened in June 2005. The 0.5% increase in sales of existing operations was due to a 2.7% increase in the average sale per funeral service. 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 as well as regular price increases. A decrease in existing home calls of 2.2% compared to the first quarter of 2005 partially offset the impact of the increase in the average sale per funeral service. The Company believes that this is a temporary reduction due to a lower number of deaths across the country.

Sales in the quarter consisted of \$18.0 million (2005 - \$17.0 million) of at-need sales of funeral merchandise and services and \$8.1 million (2005 - \$6.8 million) from the fulfilment of merchandise and services sales that were arranged on a pre-need basis. Pre-need funeral contracts written in the quarter totalled \$10.5 million compared to \$9.9 million in the first quarter of 2005, an increase of \$0.6 million or 5.5%.

Investment and other income in the funeral division decreased by \$0.1 million or 9.0% to \$1.0 million in the first quarter of 2006. The reduction was mainly attributable to a decrease in the fees received from the deposit of pre-need funeral funds under the group annuity program, which was the result of a lower average payout rate based on the type of sales made and a higher estimate of the rate of cancellation based on historical experience.

Funeral expenses in the first quarter of 2006 increased by \$2.4 million or 14.3%, of which \$1.8 million was related to new operations. Excluding the impact of new operations, expenses increased by \$0.6 million or 3.8%. A breakdown of the \$2.4 million increase by type of expenditure follows (in \$millions):

Cost of sales	0.4
Services	1.2
Facilities	0.3
Administrative	0.2
Other	0.3
	<u>2.4</u>

The increase in the cost of sales expense was related to the increase in sales. The cost of sales percentage increased by 0.1 of a percentage point. Of the \$1.2 million increase in services expense, \$1.0 million was incurred by new operations. Service expenses of existing operations increased by 3.1% in the period due mainly to regular annual wage increases. Of the remaining expense increases of \$0.8 million, new operations contributed \$0.5 million.

Earnings before interest expense and income taxes in the funeral division decreased by \$0.2 million or 2.3%, to \$7.7 million in the first quarter of 2006. The reduction was due to the marginal sales increase at existing operations and increases in expenses at existing operations in the normal course. Earnings from new operations contributed \$0.5 million compared to the first quarter of 2005.

CORPORATE DIVISION

Corporate revenue, consisting of rental income from leasing a portion of the Company's head office building and interest on the Company's bank accounts, short-term investments and mortgages receivable, was \$0.3 million in both the first quarter of 2006 and the first quarter of 2005.

Corporate expenses increased by \$0.3 million or 9.3%, to \$3.5 million in the first quarter of 2006 due mainly to an increase in depreciation of \$0.2 million as a result of the implementation of the Company's new operating system and annual increases in employee costs of \$0.1 million.

As a percentage of total Company revenue, corporate expenses for the first quarter of 2006 increased to 6.8% from 6.6% in the first quarter 2005. This was attributable to the increase in depreciation expense for the new operating system.

CONSOLIDATED BALANCE SHEETS

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

	January 31, 2006	October 31, 2005
Current ratio	2.54	2.53
Working capital (in \$millions)	43.2	46.2
Long-term debt to equity ratio	0.54	0.44
Long-term debt to EBITDA ratio ⁽¹⁾	2.50	1.91
Interest coverage ratio ⁽¹⁾	5.46	5.60

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

Working capital decreased by \$3.0 million from October 31, 2005 due to a larger decrease in current assets of \$5.3 million compared to a decrease in current liabilities of \$2.3 million. The decrease in current assets was due to a change from cash of \$11.0 million at October 31, 2005 to \$2.6 million at January 31, 2006.

The long-term debt to equity ratio and the long-term debt to EBITDA bank covenant increased by 0.10:1 and 0.59 respectively due to new debt of \$19.9 million that was borrowed to partially finance the acquisition of 7 funeral homes in the quarter for \$24.0 million.

Cash decreased by \$8.4 million from October 31, 2005 to January 31, 2006 due to payment of fiscal year-end accruals such as bonuses, vacation pay and dividends. In addition, the Company used \$4.0 million in cash to partially finance the acquisition of 7 funeral homes in the quarter.

Accounts receivable increased by \$2.2 million in the quarter, of which \$1.4 million was related to new operations. The remaining increase of \$0.8 million or 4.5% was due to higher funeral sales in the first quarter of 2006 compared to the fourth quarter of 2005.

Accounts receivable arising from at-need cemetery sales were paid on average within 53 days at January 31, 2006 (October 31, 2005 – 47 days). Accounts receivable arising from at-need funeral sales were paid on average within 33 days at January 31, 2006 (October 31, 2005 – 31 days). For comparison purposes, at-need cemetery sales were paid on average within 52 days at January 31, 2005 (October 31, 2004 – 47 days) and at-need funeral sales were paid on average within 35 days (October 31, 2004 – 30 days) at January 31, 2005.

Prepaid expenses were \$1.0 million at the end of the quarter compared to nil at the end of the 2005 fiscal year. Prepaid expenses represent insurance premiums paid at the beginning of the fiscal year that are charged to expense throughout the year.

Pre-need receivables and funds, including the current portion thereof, increased by \$21.1 million or 4.7% to \$472.8 million at the end of the first quarter, of which \$17.4 million originated from the acquisition of 7 funeral homes in the period. The remaining increase of \$3.7 million represented contributions to the funds plus realized investment income at a higher rate than deliveries of contracts out of the funds in the period.

Cemetery care funds increased by \$2.7 million or 1.9% in the quarter due to deposits to the funds resulting from collection of amounts related to cemetery burial space sales. Comparatively, cemetery care funds increased by \$2.9 million or 2.1% in the first quarter of 2005.

Crypts and niches decreased by \$1.2 million or 4.6% to \$25.0 million due to crypts and niches sold in the quarter of \$1.9 million, which was partially offset by additions of \$0.7 million. The \$0.7 million (first quarter of 2005 – \$1.7 million) in additions included \$0.5 million on crypt construction and \$0.2 million on niche construction. Of the \$0.5 million spent on crypt construction, \$0.4 million was spent on a crypt addition at Highland Memory Gardens in Toronto, Ontario.

Fixed assets in the quarter increased by \$15.1 million, which represented the net impact of \$14.5 million in assets acquired on the purchase of 7 funeral homes and \$3.0 million in other additions, which were partially offset by \$2.4 million in depreciation. The \$3.0 million in non-acquisition additions included the following:

- \$1.0 million for further development of an on-site reception centre and cemetery sales office at Mount Lawn Memorial Gardens in Whitby, Ontario;
- \$1.2 million for cemetery fixed assets and development or renovation of cemetery sales offices and services buildings;
- \$0.4 million for further development of a funeral home building addition in Edmonton, Alberta; and
- \$0.4 million for other fixed asset additions.

Goodwill increased by \$8.2 million as a result of the acquisition of 7 funeral homes in the period. Note 2 to the consolidated financial statements provides preliminary details of the purchase allocation.

Deferred obtaining costs and stored merchandise increased by \$0.5 million or 0.7% in the quarter, mainly due to a higher amount of commissions deferred in the quarter compared to commissions recognized as a result of deliveries of the underlying contract merchandise and services. Stored merchandise increased by \$0.1 million or 0.5%

Intangible and other assets increased in the quarter by \$4.8 million due to intangible assets established on the acquisition of 7 funeral homes in the period. These intangible assets represented a future benefit related to the pre-need funeral contracts acquired, the forecasted incremental cemetery contribution expected to result from the acquisition and the value of the trade name.

Bank indebtedness at January 31, 2006 was \$4.0 million and represented amounts drawn on the Company's lines of credit. This compared to no amounts drawn on the lines of credit at October 31, 2005 and \$3.9 million drawn at January 31, 2005. Cash requirements in the first quarter are generally higher due to payment of fiscal year-end accruals such as bonuses, vacation pay and dividends. In addition, the Company used \$4.0 million in cash to partially finance the acquisition of 7 funeral homes in the quarter.

Accounts payable and accrued liabilities decreased by \$8.1 million as follows (in \$millions):

Trade accounts payables	1.7
Accrued liabilities	4.9
Other accounts payable	1.5
	<u>8.1</u>

The decrease in trade accounts payable was due to lower construction and development activity at January 31, 2006 compared to October 31, 2005. Accrued liabilities were higher at October 31, 2005 due to a full year of accrued amounts, such as bonuses and vacation pay that were paid subsequent to the year-end. Of the \$1.5 million decrease in other accounts payable, \$0.7 million represented the payment of annual corporate dividends in the quarter.

Long-term debt at the end of the quarter, including the current portion, was \$96.1 million compared to \$76.2 million at the end of fiscal 2005. The increase of \$19.9 million was due to new debt in the quarter used to partially finance the acquisition of 7 funeral homes, which were purchased for \$24.0 million.

Deferred revenue, plus the non-controlling interests in pre-need trust and annuity funds, plus the accumulated benefit of the pre-need funeral group annuity funds excluded from the balance sheet was \$643.5 million at the end of the first quarter of 2006 compared to \$619.1 million at October 31, 2005, an increase of \$24.4 million or 3.9%. Of the \$24.4 million increase, \$17.4 million originated from the acquisition of 7 funeral homes in the period. The remaining increase of \$7.0 million or 1.1% represented deferral of revenue in the period in excess of amounts recognized upon delivery of merchandise and services.

Future income taxes increased by \$2.8 million due to new future taxes established on the acquisition of 7 funeral homes in the quarter of \$3.6 million. This increase was partially offset by a reversal of a portion of the future taxes related to the mortgage established on the sale of land in Markham in 2003.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Net cash used for operating activities of continuing operations in the first quarter of 2006 decreased by \$4.7 million from the first quarter of 2005 due to a lower negative net change in other operating balance sheet items of \$4.7 million and lower additions to developed land, crypts and niches of \$0.9 million. Partially offsetting the positive impact of these changes was lower net earnings from continuing operations after adjusting for non-cash

items of \$0.9 million. Non-cash items for the purpose of this calculation includes depreciation and amortization, gain on disposal of assets, future income taxes and developed land, crypt and niche cost of sales.

The lower negative net change in other operating balance sheet items was mainly due to payment of income taxes in the first quarter 2005 that were accrued at the end of 2004. This impacted the net change in other operating balance sheet items by \$3.1 million. In addition, there were higher payments of accounts payable and accrued liabilities in the first quarter of 2005 compared to the first quarter of 2006 of \$1.2 million.

Net cash used for investing activities of continuing operations increased by \$24.1 million in the first quarter of 2006 due mainly to the acquisition of 7 funeral homes in the quarter for \$24.0 million.

Net cash provided by financing activities of continuing operations increased by \$19.3 million over the first quarter of 2005 due to \$19.9 million in new debt borrowed to partially finance the acquisition of 7 funeral homes for \$24.0 million.

Management believes that cash on hand and future cash flow from operating activities are sufficient to sustain ongoing operations as well as the routine maintenance and orderly replacement of the Company's fixed assets.

CAPITAL EXPENDITURES AND CEMETERY BURIAL SPACE INVENTORY

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

Mount Lawn Memorial Gardens On-Site Reception Centre and Sales Office: At January 31, 2006, the Company had spent \$5.3 million to date on this project. The Company expects to spend an additional \$0.4 million to complete this project and expects to have the project completed in the second quarter of 2006.

Howard & McBride – Westlawn Funeral Home Addition: At January 31, 2006, the Company had spent \$1.4 million to date on this project. The Company expects to spend an additional \$0.6 million to complete this project and expects to have the project completed in the second quarter of 2006.

In addition, at January 31, 2006, the Company had spent \$18.8 million to date on cemetery land held for future development.

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

New reception centre	0.3
Cemetery burial space inventory	2.7
Cemetery maintenance capital expenditures	0.3
Funeral maintenance capital expenditures	0.1
	<u>3.4</u>

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

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

Maintenance capital expenditures	11.9
New cemetery and funeral initiatives	9.8
Cemetery burial space inventory	10.4
	<u>32.1</u>

LIQUIDITY AND CAPITAL RESOURCES

The Company anticipates that it can generate sufficient amounts of cash, in the short and the long term, to maintain the Company's capacity and to meet planned growth and development activities. At January 31, 2006,

the Company had access to unused operating lines of credit of \$8.9 million (October 31, 2005 – \$12.9 million) and unused floating-rate debt facilities of \$30.8 million (October 31, 2005 – \$50.7 million). The Company's unused operating lines of credit at January 31, 2006 were consistent with the unused lines of credit at January 31, 2005 of \$9.0 million. The unused floating-rate debt facilities decreased by \$19.9 million from October 31, 2005 due to the new debt of \$19.9 million established on the acquisition of 7 funeral homes.

The Company's debt to equity ratio at January 31, 2006 was 0.54:1 (October 31, 2005 – 0.44:1). The increase in the debt to equity ratio from the end of October 2005 was due to the acquisition of 7 funeral homes for \$24.0 million in the first quarter of 2006, which was financed using \$19.9 million in floating-rate bank debt and \$4.1 million in cash.

OUTSTANDING SHARES

The Company has an unlimited number of Preferred Shares, Class A Voting Shares and Class B Non-Voting Shares authorized for issue. The Class A and Class B shares have identical rights and privileges, except that the Class A shares are voting. In certain circumstances, if an offer is made by the Company or a third party to purchase Class A shares from each holder in Ontario, each Class B share is convertible into one Class A share. At January 31, 2006 and October 31, 2005, the Company had issued 2,525,497 Class A shares and 8,069,746 Class B shares for \$1.7 million and \$70.8 million respectively.

STOCK INFORMATION

In December 2005, the TSX Group announced that it would be discontinuing its symbol extension program. In February 2006, the TSX Group advised the Company that the symbol for the Company's Class B Non-Voting shares would be changed from "ABO.NV.B" to "ABO.B" effective Wednesday, May 17, 2006.

EVENTS AND UNCERTAINTIES

SEASONALITY

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

REGULATION

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

March 2, 2006

Arbor Memorial Services Inc.
CONSOLIDATED STATEMENTS OF EARNINGS

<i>In \$000</i>	<i>Three Months Ended January 31</i>	
	<i>2006</i>	<i>2005 ⁽¹⁾</i>
Revenue		
Sales	47,332	44,590
Investment and other income	3,509	3,549
	50,841	48,139
Expenses		
Operating	39,641	37,087
General and administrative	3,481	3,184
	43,122	40,271
Earnings before interest expense and income taxes	7,719	7,868
Interest expense	1,190	1,023
Earnings before income taxes	6,529	6,845
Income taxes (note 8)	2,139	2,337
Net earnings from continuing operations	4,390	4,508
Net earnings from discontinued operations (note 9)	40	29
Net earnings	4,430	4,537
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	0.42	0.43
Earnings per share from discontinued operations	-	-
Earnings per share - basic and diluted (in \$)	0.42	0.43

⁽¹⁾ Restated - see note 9.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

<i>In \$000</i>	<i>Three Months Ended January 31</i>	
	<i>2006</i>	<i>2005</i>
Retained earnings, beginning of period	100,462	83,679
Net earnings for the period	4,430	4,537
Retained earnings, end of period	104,892	88,216

Arbor Memorial Services Inc.
CONSOLIDATED BALANCE SHEETS

<i>In \$000</i>	<i>As at</i>	
	<i>January 31</i> <i>2006</i>	<i>October 31</i> <i>2005 ⁽¹⁾</i>
Assets		
Current assets		
Cash	2,554	10,954
Accounts receivable	19,970	17,770
Merchandise inventories	9,570	9,437
Prepaid expenses	1,003	-
Assets related to discontinued operation, current portion (note 9)	116	116
Pre-need receivables, current portion	38,008	38,214
	71,221	76,491
Pre-need receivables and funds	434,762	413,445
Cemetery care funds	147,835	145,105
Crypts and niches	25,047	26,247
Cemetery land	31,340	31,339
Fixed assets	182,477	167,351
Goodwill	52,507	44,336
Mortgage receivable	13,669	13,669
Deferred obtaining costs and stored merchandise	69,244	68,763
Assets related to discontinued operation (note 9)	3,688	3,704
Intangible and other assets (note 4)	5,960	1,208
	1,037,750	991,658
Liabilities		
Current liabilities		
Bank indebtedness	4,000	-
Accounts payable and accrued liabilities	19,066	27,117
Income taxes payable	691	721
Long-term debt, current portion	4,252	2,443
	28,009	30,281
Deferred revenue (note 6)	174,824	174,975
Non-controlling interests in pre-need funds	397,663	377,237
Long-term debt	91,850	73,720
Future income taxes (note 8)	6,573	3,757
Liabilities related to discontinued operation (note 9)	2,938	2,948
Other liabilities	10,667	10,674
	712,524	673,592
Non-controlling interests in cemetery care funds	147,835	145,105
Shareholders' equity		
Share capital (note 7)	72,499	72,499
Retained earnings	104,892	100,462
	177,391	172,961
	1,037,750	991,658

(1) Restated - see note 9.

Arbor Memorial Services Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>In \$000</i>	<i>Three Months Ended January 31</i>	
	<i>2006</i>	<i>2005 ⁽¹⁾</i>
Cash provided by (used for)		
Operating activities		
Net earnings	4,430	4,537
Net earnings from discontinued operations (note 9)	(40)	(29)
Add (deduct) items not affecting cash from operating activities:		
Depreciation and amortization	2,429	2,058
Gain on disposal of assets	(14)	(19)
Future income taxes (note 8)	(813)	227
Developed land, crypt and niche cost of sales	2,035	2,125
Additions to developed land, crypts and niches	(830)	(1,778)
Net change in other operating balance sheet items (note 11)	(10,946)	(15,614)
Net cash used for continuing operations	(3,749)	(8,493)
Net cash provided by discontinued operations	46	53
Investing activities		
Additions to fixed assets	(2,975)	(3,218)
Acquisition (note 2)	(23,981)	-
Additions to cemetery land held for future development	(6)	(12)
Proceeds on disposal of assets	14	21
Change in pre-need funds	(3,949)	(3,480)
Change in cemetery care funds	(2,730)	(2,861)
Net cash used for continuing operations	(33,627)	(9,550)
Net cash provided by (used for) for discontinued operations	7	(42)
Financing activities		
Proceeds from new long-term debt (note 2)	19,942	-
Decrease in capital lease obligation	(3)	(4)
Dividends	(742)	(742)
Change in non-controlling interests in pre-need and funds	3,003	3,526
Change in non-controlling interests in cemetery care funds	2,730	2,861
Net cash provided by continuing operations	24,930	5,641
Net cash used for discontinued operations	(7)	(6)
Decrease in cash	(12,400)	(12,397)
Cash, beginning of period	10,954	10,401
Net bank indebtedness, end of period	(1,446)	(1,996)
Made up of:		
Cash	2,554	1,900
Bank indebtedness	(4,000)	(3,896)
	(1,446)	(1,996)
Supplementary information		
Income taxes paid	2,856	5,433
Interest paid	1,138	1,069

(1) Restated - see note 9.

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

1. BASIS OF PREPARATION

The accompanying unaudited quarterly consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and are consistent with the accounting policies used to prepare the 2005 annual consolidated financial statements, except as otherwise noted herein. While management considers the interim disclosures presented to be adequate, these consolidated financial statements do not include all of the disclosures required for annual financial statements and should be read in conjunction with the Company's 2005 annual consolidated financial statements.

2. ACQUISITION

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

Assets acquired:	
Accounts receivable	778
Merchandise inventories	209
Other assets	70
Income taxes recoverable	250
Pre-need receivables and funds	17,423
Fixed assets	14,546
Intangible assets subject to amortization	2,711
Intangible asset not subject to amortization	<u>2,055</u>
	<u>38,042</u>
Liabilities assumed:	
Accounts payable and accrued liabilities	1,180
Non-controlling interests in pre-need funds	17,423
Future income taxes	<u>3,629</u>
	<u>22,232</u>
Net assets acquired	15,810
Goodwill arising on acquisition	<u>8,171</u>
Total consideration	<u><u>23,981</u></u>

In the preparation of these consolidated financial statements, the purchase consideration has been allocated on a preliminary basis to the fair value of the assets acquired and liabilities assumed based on management's best estimates and taking into account all of the relevant information available at the time the consolidated financial statements were prepared. The Company expects that the actual amounts for some of the assets and liabilities may vary from the amounts presented as the allocation is finalized.

3. PRE-NEED FUNERAL GROUP ANNUITY FUNDS

The consolidated balance sheets do not include pre-need funeral contracts that will be funded by third-party insurers under group annuity programs, upon delivery of pre-need merchandise and services, where the Company is not the policyholder. At January 31, 2006, the accumulated benefit of all such contracts was \$71.0 million (October 31, 2005 - \$67.0 million).

4. INTANGIBLE AND OTHER ASSETS

	<u>January 31</u> <u>2006</u>	<u>October 31</u> <u>2005</u>
	(\$000)	
Intangible assets subject to amortization	2,678	-
Intangible asset not subject to amortization	2,055	-
Other assets	1,227	1,208
	<u>5,960</u>	<u>1,208</u>

The intangible assets subject to amortization at January 31, 2006 represented a future benefit related to the pre-need funeral contracts acquired and the forecasted incremental cemetery contribution expected to result from the acquisition described in note 2. The intangible asset not subject to amortization represented the value of the trade name acquired in the acquisition described in note 2. The Company amortized less than \$0.1 million of the intangible assets subject to amortization in the three months ended January 31, 2006 (first quarter of 2005 – \$nil).

5. DERIVATIVE FINANCIAL INSTRUMENTS

As of January 31, 2006, the Company's use of derivative financial instruments was limited to seven (October 31, 2005 – seven) interest rate swap agreements with a Canadian chartered bank. Total debt under swap contracts at the end of the period was \$47.1 million (October 31, 2005 - \$48.4 million) and the estimated fair value of the interest rate swaps was a loss of \$1.1 million (October 31, 2005 – loss of \$1.6 million). Total swaps and other fixed rate debt represented 51% (October 31, 2005 – 66%) of the total amount of long-term debt outstanding. Swap costs for the first quarter of 2006 were \$0.3 million (first quarter of 2005 - \$0.4 million).

6. DEFERRED REVENUE

Instalment accounts receivable that have not yet been recognized in revenue are presented under deferred revenue. Upon collection, a portion of these instalment accounts receivable are required to be deposited directly to legislated trust funds. Once the Company deposits these amounts to legislated trust funds, the corresponding deferred revenue will be reclassified to non-controlling interests in pre-need funds. At January 31, 2006, \$36.3 million (October 31, 2005 – \$36.2 million) of deferred revenue related to instalment accounts receivable that will be deposited to legislated trust funds upon collection, representing 54% (October 31, 2005 – 53%) of the total outstanding instalment accounts receivable.

7. SHARE CAPITAL

Issued and outstanding

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

8. INCOME TAXES

Income tax expense

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

	<i>Three Months Ended January 31</i>	
	<u>2006</u>	<u>2005</u>
	(\$000)	
Current tax expense	2,952	2,110
Future income tax expense relating to the origination and reversal of temporary differences	<u>(813)</u>	<u>227</u>
Income tax expense	<u>2,139</u>	<u>2,337</u>

Effective income tax rate

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

	<i>Three Months Ended January 31</i>	
	<u>2006</u>	<u>2005</u>
	%	%
Combined basic federal and provincial income tax rate	33.9	34.0
Increase (decrease) in the basic tax rate resulting from:		
Large corporations tax	0.4	1.1
Non-taxable portion of capital gains	(1.5)	(0.9)
Dividends/RDTOH	(1.0)	(0.4)
Depreciation and amortization	0.7	0.5
Other changes	<u>0.3</u>	<u>(0.2)</u>
Effective income tax rate	<u>32.8</u>	<u>34.1</u>

The significant components of future income taxes are net taxable temporary differences amounting to approximately \$17.5 million (October 31, 2005 – \$9.8 million) arising from: pre-need cemetery and funeral trust income whereby certain provincial jurisdictions have permitted or currently permit the withdrawal of earned income prior to the delivery of the merchandise and services; reserves claimed for amounts received or to be received for the future delivery of certain cemetery merchandise; and the excess of share acquisition costs over book value.

9. DISCONTINUED OPERATIONS

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

Revenue associated with these operations was \$0.2 million for the first quarter of 2006 (2005 – \$0.2 million). Net earnings for the first quarter of 2006 and the first quarter of 2005 were less than \$0.1 million. The comparative amounts for the first quarter of 2005 have been reclassified for the funeral branch identified as a discontinued operation in 2005.

10. CONTRACTUAL COMMITMENTS

At January 31, 2006, the Company was contractually committed to capital and cemetery burial space inventory expenditures of \$3.4 million. The Company expects that all of these commitments will be spent within one year from January 31, 2006. In addition, the Company was contractually committed to funeral inventory purchases of \$15.5 million, which is to be purchased from February 1, 2006 to January 31, 2008. However, if the Company does not meet their commitment by January 31, 2008, the term of the commitment may be extended.

11. NET CHANGE IN OTHER OPERATING BALANCE SHEET ITEMS

	<i>Three Months Ended January 31</i>	
	<u>2006</u>	<u>2005</u>
	(\$000)	
Accounts receivable	(1,422)	(961)
Income taxes receivable	-	(649)
Prepaid expenses	(1,003)	(980)
Instalment accounts receivable	261	1,172
Deferred obtaining costs and stored merchandise	(481)	(745)
Accounts payable and accrued liabilities	(8,489)	(9,665)
Income taxes payable	220	(2,832)
Deferred revenue	(151)	(854)
Other liabilities	(7)	(383)
Other changes	126	283
	<u>(10,946)</u>	<u>(15,614)</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>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Sales ⁽¹⁾	21,041	20,633	26,143	23,811	148	146	47,332	44,590
Investment and other income ⁽¹⁾	2,343	2,291	979	1,076	187	182	3,509	3,549
Revenue ⁽¹⁾	<u>23,384</u>	<u>22,924</u>	<u>27,122</u>	<u>24,887</u>	<u>335</u>	<u>328</u>	<u>50,841</u>	<u>48,139</u>
Depreciation and amortization ⁽¹⁾	779	735	1,280	1,165	370	158	2,429	2,058
Earnings before interest expense and income taxes	3,133	2,807	7,732	7,917	(3,146)	(2,856)	7,719	7,868
Interest expense	-	-	-	-	1,190	1,023	1,190	1,023
Earnings before income taxes	<u>3,133</u>	<u>2,807</u>	<u>7,732</u>	<u>7,917</u>	<u>(4,336)</u>	<u>(3,879)</u>	<u>6,529</u>	<u>6,845</u>
Identifiable assets ⁽²⁾	547,986	541,976	463,198	420,421	26,566	29,261	1,037,750	991,658
Capital expenditures	2,336	976	482	1,885	157	357	2,975	3,218
Developed land, crypt and niche additions	830	1,778	-	-	-	-	830	1,778
Cemetery land held for future development additions	6	12	-	-	-	-	6	12
Pre-need contracts written	15,417	15,215	10,470	9,920	-	-	25,887	25,135

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

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