

STONEMOR PARTNERS LP  
Form 10-Q  
May 10, 2007

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE QUARTERLY PERIOD ENDED March 31, 2007

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE TRANSITION PERIOD FROM \_\_\_\_ TO \_\_\_\_.

Commission File Number: 000-50910

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**STONEMOR PARTNERS L.P.**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

80-0103159  
(I.R.S. Employer  
Identification No.)

155 Rittenhouse Circle

19007

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**Bristol, Pennsylvania**  
(Address of principal executive offices)

(Zip Code)

**(215) 826-2800**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of the registrant's outstanding common units at May 9, 2007 was 4,795,750.

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|  | <b>Page</b> |
|--|-------------|
| <b>Part I</b>  |             |
| <u>Financial Information</u>   |             |
| Item 1. <u>Financial Statements - Unaudited</u>  | 1           |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 15          |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>                            | 29          |
| Item 4. <u>Controls and Procedures</u>   | 31          |
| <b>Part II</b>   |             |
| <u>Other Information</u>   |             |
| Item 1. <u>Legal Proceedings</u>   | 31          |
| Item 1A. <u>Risk Factors</u>   | 32          |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | 32          |
| Item 3. <u>Defaults Upon Senior Securities</u>   | 32          |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u>                                   | 32          |
| Item 5. <u>Other Information</u>   | 32          |
| Item 6. <u>Exhibits</u>  | 33          |
| <u>Signatures</u>  | 34          |

## Part I Financial Information

## Item 1. Financial Statements

## StoneMor Partners L.P.

## Condensed Consolidated Balance Sheets

(in thousands)

(unaudited)

|  | December 31,<br>2006 | March 31,<br>2007 |
|--|----------------------|-------------------|
| <b>ASSETS</b>  |                      |                   |
| CURRENT ASSETS:  |                      |                   |
| Cash and cash equivalents                                | \$ 9,914             | \$ 6,550          |
| Accounts receivable, net of allowance                    | 22,968               | 23,664            |
| Prepaid expenses   | 2,801                | 2,165             |
| Other current assets                                     | 2,533                | 3,120             |
| Total current assets                                     | 38,216               | 35,499            |
| LONG-TERM ACCOUNTS RECEIVABLE net of allowance           | 36,878               | 37,682            |
| CEMETERY PROPERTY  | 171,714              | 170,992           |
| PROPERTY AND EQUIPMENT, net of accumulated depreciation  | 29,027               | 28,987            |
| MERCHANDISE TRUSTS, restricted, at fair value            | 147,788              | 159,221           |
| PERPETUAL CARE TRUSTS, restricted, at fair value         | 168,631              | 172,678           |
| DEFERRED FINANCING COSTS net of accumulated amortization | 1,242                | 1,056             |
| DEFERRED SELLING AND OBTAINING COSTS                     | 33,478               | 34,996            |
| OTHER ASSETS   | 51                   | 158               |
| TOTAL ASSETS   | \$ 627,025           | \$ 641,269        |
| <b>LIABILITIES AND PARTNERS EQUITY</b>                   |                      |                   |
| CURRENT LIABILITIES:                                     |                      |                   |
| Accounts payable and accrued liabilities                 | \$ 11,345            | \$ 8,563          |
| Accrued interest   | 361                  | 349               |
| Current portion, long-term debt                          | 1,388                | 1,155             |
| Total current liabilities                                | 13,094               | 10,067            |
| LONG-TERM DEBT   | 102,104              | 103,879           |
| DEFERRED CEMETERY REVENUES, net                          | 196,103              | 207,501           |
| MERCHANDISE LIABILITY                                    | 45,805               | 51,117            |
| TOTAL LIABILITIES  | 357,106              | 372,564           |
| COMMITMENTS AND CONTINGENCIES                            |                      |                   |
| NON-CONTROLLING INTEREST IN PERPETUAL CARE TRUSTS        | 168,631              | 172,678           |
| PARTNERS EQUITY  |                      |                   |
| General partner  | 1,382                | 1,277             |
| Limited partners:  |                      |                   |
| Common   | 71,700               | 68,963            |

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|   |                   |                   |
|---|-------------------|-------------------|
| Subordinated                                  | 28,206            | 25,787            |
| Total partners' equity                        | 101,288           | 96,027            |
| <b>TOTAL LIABILITIES AND PARTNERS' EQUITY</b> | <b>\$ 627,025</b> | <b>\$ 641,269</b> |

See Accompanying Notes to the Condensed Consolidated Financial Statements.

## StoneMor Partners L.P.

## Condensed Consolidated Statement of Operations

(in thousands, except unit data)

(unaudited)

|  | Three months ended March 31, |                 |
|--|------------------------------|-----------------|
|  | 2006                         | 2007            |
| <b>Revenues:</b>   |                              |                 |
| Cemetery   | \$ 25,192                    | \$ 27,510       |
| Funeral home   | 1,460                        | 3,030           |
| Total revenues   | 26,652                       | 30,540          |
| <b>Costs and Expenses:</b>   |                              |                 |
| Cost of goods sold (exclusive of depreciation shown separately below):             |                              |                 |
| Land and crypts  | 1,447                        | 1,289           |
| Perpetual care   | 736                          | 888             |
| Merchandise  | 1,273                        | 1,727           |
| Cemetery expense   | 5,636                        | 6,784           |
| Selling expense  | 5,647                        | 6,244           |
| General and administrative expense   | 3,064                        | 3,738           |
| Corporate overhead (including \$1,158 in stock-based compensation in 2007)         | 3,808                        | 5,282           |
| Depreciation and amortization  | 821                          | 874             |
| Funeral home expense   | 1,093                        | 2,103           |
| Total cost and expenses  | 23,525                       | 28,929          |
| <b>OPERATING PROFIT</b>  | <b>3,127</b>                 | <b>1,611</b>    |
| <b>INTEREST EXPENSE</b>  | <b>1,733</b>                 | <b>2,046</b>    |
| <b>INCOME (LOSS) BEFORE INCOME TAXES</b>   | <b>1,394</b>                 | <b>(435)</b>    |
| <b>INCOME TAXES:</b>   |                              |                 |
| State  | 143                          | 133             |
| Federal  | 310                          | 83              |
| Total income taxes   | 453                          | 216             |
| <b>NET INCOME (LOSS)</b>   | <b>\$ 941</b>                | <b>\$ (651)</b> |
| General partner's interest in net income (loss) for the period                     | \$ 19                        | \$ (13)         |
| Limited partners' interest in net income (loss) for the period                     |                              |                 |
| Common   | \$ 476                       | \$ (339)        |
| Subordinated   | \$ 446                       | \$ (299)        |
| Net income (loss) per limited partner unit (basic and diluted)                     | \$ .11                       | \$ (.07)        |
| Weighted average number of limited partners' units outstanding (basic and diluted) | 8,763                        | 9,036           |

See Accompanying Notes to the Condensed Consolidated Financial Statements.

**StoneMor Partners L.P.**

**Condensed Consolidated Statement of**

**Partners Equity**

(in thousands)

(unaudited)

|                            | <b>Partners Capital</b> |                     |              | <b>General</b> |              |
|----------------------------|-------------------------|---------------------|--------------|----------------|--------------|
|                            | <b>Common</b>           | <b>Subordinated</b> | <b>Total</b> | <b>Partner</b> | <b>Total</b> |
| Balance, December 31, 2006 | \$ 71,700               | \$ 28,206           | \$ 99,906    | \$ 1,382       | \$ 101,288   |
| Net loss                   | (339)                   | (299)               | (638)        | (13)           | (651)        |
| Cash distribution          | (2,398)                 | (2,120)             | (4,518)      | (92)           | (4,610)      |
| Balance, March 31, 2007    | \$ 68,963               | \$ 25,787           | \$ 94,750    | \$ 1,277       | \$ 96,027    |

See Accompanying Notes to the Condensed Consolidated Financial Statements.

## StoneMor Partners L.P.

## Condensed Consolidated Statement of Cash Flows

(in thousands)

(unaudited)

|   | <b>Three months ended March 31,</b> |                 |
|---|-------------------------------------|-----------------|
|   | <b>2006</b>                         | <b>2007</b>     |
| <b>OPERATING ACTIVITIES:</b>  |                                     |                 |
| Net income (loss)   | \$ 941                              | \$ (651)        |
| Adjustments to reconcile net income to net cash provided by operating activity: |                                     |                 |
| Cost of lots sold   | 1,043                               | 1,217           |
| Depreciation and amortization   | 821                                 | 874             |
| Stock-based compensation  |                                     | 1,158           |
| Other non cash  | 207                                 |                 |
| Changes in assets and liabilities that provided (used) cash:                    |                                     |                 |
| Accounts receivable   | 280                                 | (1,973)         |
| Allowance for doubtful accounts   | 397                                 | 473             |
| Merchandise trust fund  | (1,513)                             | (1,268)         |
| Prepaid expenses  | (96)                                | 637             |
| Other current assets  | (339)                               | (64)            |
| Other assets  | (38)                                | (107)           |
| Accounts payable and accrued and other liabilities                              | (1,558)                             | (3,955)         |
| Deferred selling and obtaining costs  | (798)                               | (1,322)         |
| Deferred cemetery revenue   | 4,061                               | 6,486           |
| Merchandise liability   | (765)                               | (137)           |
| <b>Net cash provided by operating activities</b>                                | <b>2,643</b>                        | <b>1,368</b>    |
| <b>INVESTING ACTIVITIES:</b>  |                                     |                 |
| Cost associated with potential acquisitions                                     | (464)                               | (522)           |
| Additions to cemetery property  | (878)                               | (495)           |
| Divestiture of funeral home   | 2,091                               |                 |
| Additions to property and equipment   | (458)                               | (648)           |
| <b>Net cash provided by (used in) investing activities</b>                      | <b>291</b>                          | <b>(1,665)</b>  |
| <b>FINANCING ACTIVITIES:</b>  |                                     |                 |
| Cash distribution   | (4,247)                             | (4,610)         |
| Additional borrowings on long-term debt   | 1,400                               | 2,000           |
| Repayments of long-term debt  | (288)                               | (457)           |
| <b>Net cash used in financing activities</b>                                    | <b>(3,135)</b>                      | <b>(3,067)</b>  |
| <b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>                                | <b>(201)</b>                        | <b>(3,364)</b>  |
| <b>CASH AND CASH EQUIVALENTS</b> Beginning of period                            | 6,925                               | 9,914           |
| <b>CASH AND CASH EQUIVALENTS</b> End of period                                  | <b>\$ 6,724</b>                     | <b>\$ 6,550</b> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>                         |                                     |                 |
| Cash paid during the period for interest  | \$ 1,772                            | \$ 2,277        |



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|  |    |       |    |     |
|--|----|-------|----|-----|
| Cash paid during the period for income taxes | \$ | 1,671 | \$ | 973 |
|--|----|-------|----|-----|

See Accompanying Notes to the Condensed Consolidated Financial Statements.

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## 1. NATURE OF OPERATIONS, BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation.** StoneMor Partners L.P. ( StoneMor , the Partnership or the Company ) headquartered in Bristol, Pennsylvania, is an owner and operator of cemeteries in the United States, with 176 cemeteries and 27 funeral homes in 20 states. StoneMor is the only publicly traded deathcare company structured as a partnership.

**Interim Financial Data** The interim financial data are unaudited. However, in the opinion of management, the interim financial data as of March 31, 2007 and for the three months ended March 31, 2007 and 2006 include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim. The results of operations for interim periods are not necessarily indicative of the results of operations to be expected for a full year.

**Summary of Significant Accounting Policies** Significant accounting policies followed by the Company, as summarized below, are in conformity with accounting principles generally accepted in the United States of America.

**Principles of Consolidation** The condensed consolidated financial statements include the accounts of each of the Company's subsidiaries. These statements also include the accounts of the merchandise and perpetual care trusts in which the Company has a variable interest and is the primary beneficiary. The operations of the 6 managed cemeteries that the Company operates under long-term management contracts are also consolidated in accordance with the provisions of Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46 revised (FIN 46R), Consolidation of Variable Interest Entities: an Interpretation of Accounting Research Bulletin (ARB) No. 51.

Total revenues derived from the cemeteries under long term management contracts totaled approximately \$5.9 million and \$5.6 million for the three months ended March 31, 2006 and 2007, respectively.

**Cemetery Operations** Sales of at-need cemetery interment rights, merchandise and services are recognized when the service is performed or merchandise is delivered. In accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, Revenue Recognition in Financial Statements (SAB No. 104), and the retail land sales provisions of Statement of Financial Accounting Standards No. 66, Accounting for the Sale of Real Estate (SFAS No. 66), revenues from pre-need sales of burial lots and constructed mausoleum crypts and lawn crypts are deferred until at least 10% of the sales price has been collected. At the time of the sale, an allowance for customer cancellations is established, which reduces the amount of accounts receivable, net and deferred cemetery revenues, net or cemetery revenue recognized, based on management's estimates of expected cancellations and historical experiences. Historically, the cancelled contracts represent approximately 10% of the pre-need sales (based on contract dollar amounts). Revenues from the pre-need sale of unconstructed mausoleum and lawn crypts are deferred until at least 10% of the sales price has been collected, at which point revenues are recognized using the percentage-of-completion method of accounting, also in accordance with SFAS No. 66. Revenues related to the pre-need sale of merchandise and services are deferred until such merchandise is delivered (title has transferred to the customer and the merchandise is either installed or stored, at the direction of the customer, at the vendor's warehouse or a third-party warehouse at no additional cost to us) or such services are performed.

The Company also defers certain pre-need cemetery and prearranged funeral direct obtaining costs that vary with and are primarily related to the acquisition of new pre-need cemetery and prearranged funeral business. Such costs are accounted for under the provisions of SFAS No. 60, Accounting and Reporting by Insurance Enterprises (SFAS No. 60), and are expensed as revenues are recognized.

Costs related to the sales of interment rights include property and other costs related to cemetery development activities that are specifically identified by project. At the completion of a project, costs are charged to operations as revenues are recognized. Costs related to merchandise and services are based on actual costs incurred or estimates of future costs necessary, including provisions for inflation when required.

The Company records a merchandise liability at the time it enters into a pre-need contract with a customer at the estimated cost to purchase the merchandise or provide the service. The merchandise liability is reduced when payment for the merchandise is made by the Company and title to the merchandise is transferred to the customer. The merchandise liability is also reduced when the contracted service is performed by the Company. Allowances for customer cancellations arising from non-payment are provided at the date of sale based upon management's estimates of expected cancellations and historical experience. Actual cancellation rates in the future may result in a change in estimate. Actual cancellations did not vary significantly from the estimates of expected cancellations at March 31, 2006 and March 31, 2007.

Pursuant to state law, a portion of the proceeds from cemetery merchandise or services sold on a pre-need basis is required to be paid into merchandise trusts. The Company defers investment earnings generated by the assets in these merchandise trusts (including realized gains and losses) until the associated merchandise is delivered or the services are performed. The fair value of the funds held in merchandise trusts at December 31, 2006 and March 31, 2007 was approximately \$147.8 million and \$159.2 million, respectively (see Note 5). A portion of the proceeds from the sale of cemetery property is required by state law to be paid into perpetual care trusts. Earnings from the perpetual care trusts are recognized in current cemetery revenues and are used to defray cemetery maintenance costs, which are expensed as incurred. Funds held in perpetual care trusts at December 31, 2006 and March 31, 2007 were \$168.6 million and \$172.7 million, respectively (see Note 6).

**Cash and Cash Equivalents** The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

**Concentration of Credit Risk** The Company's revenues and accounts receivable relate to the sale of products and services to a customer base that is almost entirely concentrated in the states where the Company has cemeteries and funeral homes. The Company retains a security interest in any merchandise sold pursuant to the pre-need contracts. The condensed consolidated balance sheets contain a provision for cancellations arising from non-payment in amounts determined based on historical experience and the judgment of Company's management.

**Inventories** Inventories, classified as other current assets on the Company's condensed consolidated balance sheets, include cemetery and funeral home merchandise and are valued at the lower of cost or net realizable value. Cost is determined primarily on a specific identification basis on a first-in, first-out basis. Inventories were approximately \$2.2 million and \$2.3 million at December 31, 2006 and March 31, 2007, respectively.

**Cemetery Property** Cemetery property consists of developed and undeveloped cemetery property and constructed mausoleum crypts and lawn crypts and is valued at cost, which is not in excess of market value.

**Property and Equipment** Property and equipment is recorded at cost and depreciated on a straight-line basis. Maintenance and repairs are charged to expense as incurred, whereas additions and major replacements are capitalized and depreciation is recorded over their estimated useful lives as follows:

|                            |                            |
|----------------------------|----------------------------|
| Buildings and improvements | 10 to 40 years             |
| Furniture and equipment    | 5 to 10 years              |
| Leasehold improvements     | over the term of the lease |

For the three months ended March 31, 2006 and 2007, depreciation expense was \$0.8 million and \$0.7 million, respectively.

**Deferred Cemetery Revenues, Net** Revenues and all costs associated with pre-need sales of cemetery merchandise and services are deferred until the merchandise is delivered or the services are performed. In addition, investment earnings generated by the assets included in the merchandise trusts are deferred until the associated merchandise is delivered or the services are performed. Deferred cemetery revenues, net, also includes deferred revenues from pre-need sales that were entered into by entities prior to the acquisition of those entities by the Company, including entities that were acquired by Cornerstone Family Services, Inc. (Cornerstone) upon its formation in 1999. The Company provides for a reasonable profit margin for these deferred revenues (deferred margin) to account for the future costs of delivering products and providing services on pre-need contracts that the Company acquired through acquisition. Deferred margin amounts are deferred until the merchandise is delivered or services are performed.

**Merchandise Liability** Merchandise liability accounts for merchandise and services that have been contracted for but not yet delivered or performed. This liability is recorded at the estimated cost and is expensed to cost of goods sold as merchandise is delivered and services are performed.

**Allowance for Cancellations.** Allowances for cancellations arising from non-payment of pre-need contracts are estimated at the date of sale based upon our historical cancellation experience. Due to the number of estimates and projections used in determining an expected cancellation rate and the possibility of changes in collection patterns resulting from modifications to our collection policies or contract terms, actual collections could differ from these estimates.

**Impairment of Long-Lived Assets** The Company monitors the recoverability of long-lived assets, including cemetery property, property and equipment and other assets, based on estimates using factors such as current market value, future asset utilization, business and regulatory climate and future undiscounted cash flow expected to result from the use of the related assets. The Company's policy is to evaluate an asset for impairment when events or circumstances indicate that a long-lived asset's carrying value may not be recovered. An impairment charge is recorded to write-down the asset to its fair value if the sum of future undiscounted cash flows is less than the carrying value of the asset.



**Income Taxes** The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. The tax effects of temporary differences between income for financial statement and income tax purposes are recognized in the financial statements. The differences arise primarily from receivables and depreciation.

***New Accounting Pronouncements***

Effective January 1, 2006, the Company adopted SFAS No. 123R, which replaces FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123) and supercedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. Prior to January 1, 2006, the Company did not have any outstanding stock-based employee compensation plans. See Note 11.

In July 2006, the Financial Accounting Standards Board issued FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109*. Interpretation 48, which clarifies Statement 109, *Accounting for Income Taxes*, establishes the criterion that an individual tax position has to meet for some or all of the benefits of that position to be recognized in the Company's financial statements. On initial application, Interpretation 48 will be applied to all tax positions for which the statute of limitations remains open. Only tax positions that meet the more-likely-than-not recognition threshold at the adoption date will be recognized or continue to be recognized. The cumulative effect of applying Interpretation 48 will be reported as an adjustment to retained earnings at the beginning of the period in which it is adopted. Interpretation 48 is effective for fiscal years beginning after December 15, 2006. The adoption of Interpretation 48 did not have a significant effect on the Company's financial statements or its ability to comply with its current debt covenants.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( FAS 157 ). FAS 157 defines fair value, establishes a market-based framework or hierarchy for measuring fair value, and expands disclosures about fair value measurements. FAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. FAS 157 does not expand or require any new fair value measures, however the application of this statement may change current practice. The requirements of FAS 157 are effective for our fiscal year beginning January 1, 2008. We are in the process of evaluating this guidance and therefore have not yet determined the impact that FAS 157 will have on our financial statements upon adoption.

In September 2006, the SEC released SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ( SAB 108 ), which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The provisions of SAB 108 became effective beginning November 15, 2006. The impact of SAB 108 in the future depends on the nature and extent of any prior year misstatements.

In February 2007, the FASB issued SFAS No. 159, *Establishing the Fair Value Option for Financial Assets and Liabilities*, to permit all entities to choose to elect to measure eligible financial instruments at fair value. SFAS No. 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS No. 157, *Fair Value Measurements*. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. The Company is currently evaluating the impact of SFAS No. 159 on the consolidated financial statements.

**Segment Reporting and Related Information** The Company has one reportable segment, death care services.

Disclosure of reported segment revenue:

|  | <b>Three Months Ended March 31,</b> |             |
|--|-------------------------------------|-------------|
|  | <b>2006</b>                         | <b>2007</b> |
|  | <b>(in thousands)</b>               |             |
| Revenues:  |                                     |             |
| Cemetery:  |                                     |             |
| Sales  | \$ 15,003                           | \$ 16,030   |
| Services and other   | 6,921                               | 7,497       |
| Investment, including realized gains from merchandise trusts and receivables | 2,832                               | 3,410       |
| Deferred margin, recognized  | 436                                 | 573         |
|  | 25,192                              | 27,510      |
| Funeral home revenues  | 1,460                               | 3,030       |
| Total revenues   | \$ 26,652                           | \$ 30,540   |

## 2. LONG-TERM ACCOUNTS RECEIVABLE, NET OF ALLOWANCE

Long-term accounts receivable, net, consist of the following:

|  | <b>December 31,</b>   | <b>March 31,</b> |
|--|-----------------------|------------------|
|  | <b>2006</b>           | <b>2007</b>      |
|  | <b>(in thousands)</b> |                  |
| Customer receivables                   | \$ 81,584             | \$ 83,461        |
| Unearned finance income                | (9,495)               | (10,228)         |
| Allowance for contract cancellations   | (12,243)              | (11,887)         |
|  | 59,846                | 61,346           |
| Less: current portion net of allowance | 22,968                | 23,664           |
| Long-term portion net of allowance     | \$ 36,878             | \$ 37,682        |

Activity in the allowance for contract cancellations is as follows:

|                               | <b>December 31,</b>   | <b>March 31,</b> |
|-------------------------------|-----------------------|------------------|
|                               | <b>2006</b>           | <b>2007</b>      |
|                               | <b>(in thousands)</b> |                  |
| Balance Beginning of period   | \$ 9,261              | \$ 12,243        |
| Reserve on acquired contracts | 926                   |                  |
| Provision for cancellations   | 8,363                 | 2,498            |
| Charge-offs net               | (6,307)               | (2,854)          |
| Balance End of period         | \$ 12,243             | \$ 11,887        |

**3. CEMETERY PROPERTY**

Cemetery property consists of the following:

|                                  | December 31,<br>2006 | March 31,<br>2007 |
|----------------------------------|----------------------|-------------------|
|                                  | (in thousands)       |                   |
| Developed land                   | \$ 21,981            | \$ 21,563         |
| Undeveloped land                 | 114,175              | 114,175           |
| Mausoleum crypts and lawn crypts | 35,558               | 35,254            |
| <br>Total                        | <br>\$ 171,714       | <br>\$ 170,992    |

**4. PROPERTY AND EQUIPMENT**

Major classes of property and equipment follow:

|                                | December 31,<br>2006 | March 31,<br>2007 |
|--------------------------------|----------------------|-------------------|
|                                | (in thousands)       |                   |
| Building and improvements      | \$ 29,202            | \$ 29,395         |
| Furniture and equipment        | 21,966               | 22,461            |
|                                | 51,168               | 51,856            |
| Less: accumulated depreciation | (22,141)             | (22,869)          |
| <br>Property and equipment net | <br>\$ 29,027        | <br>\$ 28,987     |

**5. PRE-NEED MERCHANDISE AND SERVICES AND MERCHANDISE TRUSTS.**

**Cemetery** In connection with the pre-need sale of cemetery interment rights, merchandise and services, the customer typically enters into an installment contract with the Company. The contract is usually for a period not to exceed 60 months with payments of principal and interest required. Interest is imputed for contracts that do not bear a market rate of interest (at a rate of 8.75% during the year ended December 31, 2006 and 9.75% during the three months ended March 31, 2007). The Company establishes an allowance for cancellations due to non-payment at the date of sale based on historic experience and management's estimates. The allowance is reviewed quarterly and changes in estimates are reflected for current and prior contracts as a result of recent cancellation experience. Actual cancellation rates in the future may result in a change in estimate.

The Company evaluates the collectibility of the assets held in merchandise trusts for impairment when the fair values of the assets are below the recorded asset balance. Assets are deemed to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts from the merchandise trust at the time such amounts are due. In those instances when the amount is deemed to be impaired, the merchandise trust is reduced to the currently estimated recoverable amount with a corresponding reduction to the associated deferred cemetery revenues balance. There is no income statement impact as long as deferred revenues are not below the estimated costs to deliver the underlying products or services. If the deferred revenue were to decrease below the estimated cost to deliver the underlying products or services, the Company would record a charge to earnings for the difference.

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At December 31, 2006, the cost and market value associated with the assets held in merchandise trusts follows:

|  | Cost           | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Market     |
|--|----------------|------------------------------|-------------------------------|------------|
|  | (In Thousands) |                              |                               |            |
| Short-term investment                  | \$ 19,423      | \$                           | \$                            | \$ 19,423  |
| Fixed maturities:                      |                |                              |                               |            |
| U.S. Government and federal agency     | 3,572          | 7                            | (47)                          | 3,532      |
| U.S. State and local government agency | 2,453          | 6                            | (33)                          | 2,426      |
| Corporate debt securities              | 3,875          | 62                           | (26)                          | 3,911      |
| Other debt securities                  | 56,737         | 558                          | (1,067)                       | 56,228     |
| Total fixed maturities                 | 66,637         | 633                          | (1,173)                       | 66,097     |
| Equity securities                      | 57,471         | 5,365                        | (568)                         | 62,268     |
| Total                                  | \$ 143,531     | \$ 5,998                     | \$ (1,741)                    | \$ 147,788 |

At March 31, 2007, the cost and market value associated with the assets held in merchandise trusts follows:

|  | Cost           | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Market     |
|--|----------------|------------------------------|-------------------------------|------------|
|  | (In Thousands) |                              |                               |            |
| Short-term investment                  | \$ 15,111      | \$                           | \$                            | \$ 15,111  |
| Fixed maturities:                      |                |                              |                               |            |
| U.S. Government and federal agency     | 3,646          | 9                            | (39)                          | 3,616      |
| U.S. State and local government agency | 2,347          | 11                           | (29)                          | 2,329      |
| Corporate debt securities              | 4,114          | 91                           | (18)                          | 4,187      |
| Other debt securities                  | 43,957         | 132                          | (503)                         | 43,586     |
| Total fixed maturities                 | 54,064         | 243                          | (589)                         | 53,718     |
| Equity securities                      | 83,928         | 6,718                        | (254)                         | 90,392     |
| Total                                  | \$ 153,103     | \$ 6,961                     | \$ (843)                      | \$ 159,221 |

An aging of unrealized losses on the Company's investments in fixed maturities and equity securities at March 31, 2007 is presented below:

|  | Less than 12 months |                      | 12 Months or more |                      | Total         |                      |
|--|---------------------|----------------------|-------------------|----------------------|---------------|----------------------|
|  | Fair<br>Value       | Unrealized<br>Losses | Fair<br>Value     | Unrealized<br>Losses | Fair<br>Value | Unrealized<br>Losses |
|  | (In Thousands)      |                      |                   |                      |               |                      |
| Fixed maturities:                      |                     |                      |                   |                      |               |                      |
| U.S. Government and federal agency     | \$ 1,979            | \$ 36                | \$ 229            | \$ 3                 | \$ 2,208      | \$ 39                |
| U.S. State and local government agency | 805                 | 2                    | 613               | 27                   | 1,418         | 29                   |
| Corporate debt securities              | 947                 | 10                   | 524               | 7                    | 1,471         | 17                   |
| Other debt securities                  |                     |                      | 14,477            | 504                  | 14,477        | 504                  |
| Total fixed maturities                 | 3,731               | 48                   | 15,843            | 541                  | 19,574        | 589                  |



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|                   |          |        |           |        |           |        |
|-------------------|----------|--------|-----------|--------|-----------|--------|
| Equity securities | 3,687    | 192    | 2,098     | 62     | 5,785     | 254    |
| Total             | \$ 7,418 | \$ 240 | \$ 17,941 | \$ 603 | \$ 25,359 | \$ 843 |

The Company considers various factors when considering if a decline in fair value of an asset is other than temporary, including but not limited to the length of time and magnitude of the unrealized loss; the volatility of the investment; the credit ratings of the issuers of the investments; and the Company's intentions to sell or ability to hold the investments. At March 31, 2007, the Company has concluded that the declines in the fair values of the Company's investments in fixed maturities and equity securities held by the merchandise trusts are temporary.

The company deposited \$4,307 and \$4,973 and withdrew \$5,164 and \$6,978 from the trusts during the three month period ended March 31, 2006 and 2007, respectively. During the three months ended March 31, 2006, purchase and sales of securities available for sale included in trust investments were \$22,794 and \$20,925, respectively. During the three months ended March 31, 2007, purchase and sales of securities available for sale included in trust investments were \$35,782 and \$30,799, respectively.

**Funeral Home** Prearranged funeral home services provide for future funeral home services generally determined by prices prevailing at the time that the contract is signed. A portion of the payments made under funeral home pre-need contracts is placed in funeral trusts. Amounts used to defray the initial cost of administration are not placed in trust. The balance of the amounts in the trusts totaled approximately \$1.8 million at December 31, 2006 and approximately \$6.7 million at March 31, 2007 and are included within the merchandise trusts above. Funeral trust principal, together with investment earnings retained in trust, are deferred until the service is performed. Upon performance of the contracted funeral home service, the Company recognizes the funeral trust principal amount together with the accumulated trust earnings as funeral home revenues.

## 6. PERPETUAL CARE TRUSTS.

At December 31, 2006, the cost and market value associated with the assets held in perpetual care trust follows:

|  | Cost           | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Market     |
|--|----------------|------------------------------|-------------------------------|------------|
|  | (In Thousands) |                              |                               |            |
| Short-term investment                  | \$ 18,092      | \$                           | \$                            | \$ 18,092  |
| Fixed maturities:                      |                |                              |                               |            |
| U.S. Government and federal agency     | 6,239          | 19                           | (45)                          | 6,213      |
| U.S. State and local government agency | 5,082          | 22                           | (20)                          | 5,084      |
| Corporate debt securities              | 14,796         | 337                          | (67)                          | 15,066     |
| Other debt securities                  | 73,471         | 1,857                        | (84)                          | 75,244     |
| Total fixed maturities                 | 99,588         | 2,235                        | (216)                         | 101,607    |
| Equity Securities                      | 43,966         | 5,082                        | (116)                         | 48,932     |
| Total                                  | \$ 161,646     | \$ 7,317                     | \$ (332)                      | \$ 168,631 |

At March 31, 2007, the cost and market value associated with the assets held in perpetual care trust follows:

|  | Cost           | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Market     |
|--|----------------|------------------------------|-------------------------------|------------|
|  | (In Thousands) |                              |                               |            |
| Short-term investment                  | \$ 10,927      | \$                           | \$                            | \$ 10,927  |
| Fixed maturities:                      |                |                              |                               |            |
| U.S. Government and federal agency     | 6,430          | 28                           | (35)                          | 6,423      |
| U.S. State and local government agency | 4,512          | 37                           | (16)                          | 4,533      |
| Corporate debt securities              | 15,455         | 401                          | (65)                          | 15,791     |
| Other debt securities                  | 77,768         | 2,062                        | (1)                           | 79,829     |
| Total fixed maturities                 | 104,165        | 2,528                        | (117)                         | 106,576    |
| Equity Securities                      | 49,699         | 5,635                        | (159)                         | 55,175     |
| Total                                  | \$ 164,791     | \$ 8,163                     | \$ (276)                      | \$ 172,678 |

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An aging of unrealized losses on the Company's investments in fixed maturities and equity securities at March 31, 2007 held in perpetual care trusts is presented below:

|  | Less than 12 months |                   | 12 Months or more |                   | Total            |                   |
|--|---------------------|-------------------|-------------------|-------------------|------------------|-------------------|
|  | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value       | Unrealized Losses |
|  | (In Thousands)      |                   |                   |                   |                  |                   |
| <b>Fixed maturities:</b>               |                     |                   |                   |                   |                  |                   |
| U.S. Government and federal agency     | \$ 1,850            | \$ 25             | \$ 314            | \$ 10             | \$ 2,164         | \$ 35             |
| U.S. State and local government agency | 1,247               | 10                | 204               | 7                 | 1,451            | 17                |
| Corporate debt securities              | 3,019               | 39                | 1,717             | 25                | 4,736            | 64                |
| Other debt securities                  | 46,524              | 1                 |                   |                   | 46,524           | 1                 |
| <b>Total fixed maturities</b>          | <b>52,640</b>       | <b>75</b>         | <b>2,235</b>      | <b>42</b>         | <b>54,875</b>    | <b>117</b>        |
| <b>Equity Securities</b>               | <b>1,379</b>        | <b>50</b>         | <b>5,131</b>      | <b>109</b>        | <b>6,510</b>     | <b>159</b>        |
| <b>Total</b>                           | <b>54,019</b>       | <b>\$ 125</b>     | <b>\$ 7,366</b>   | <b>\$ 151</b>     | <b>\$ 61,385</b> | <b>\$ 276</b>     |

The Company considers various factors when considering if a decline in fair value of an asset is other than temporary, including but not limited to the length of time and magnitude of the unrealized loss; the volatility of the investment; the credit ratings of the issuers of the investments; and the Company's intentions to sell or ability to hold the investments. At March 31, 2007, the Company has concluded that the declines in the fair values of the Company's investments in fixed maturities and equity securities held in perpetual care trusts are temporary.

The company deposited \$1,026 and \$1,232 and withdrew \$2,198 and \$2,635 from the trusts during the three months ended March 31, 2006 and 2007, respectively. During the three months ended March 31, 2006, purchase and sales of securities available for sale included in trust investments were \$10,710 and \$8,889, respectively. During the three months ended March 31, 2007, purchase and sales of securities available for sale included in trust investments were \$109,339 and \$91,418, respectively.

The Company recorded income from perpetual care trusts of \$ \$1.9 million for the three months ended March 31, 2006, respectively and \$2.2 million during the same period of 2007. This income is classified as cemetery revenues in the consolidated statements of operations.

## 7. LONG-TERM DEBT

The following is a summary of debt outstanding at:

|   | December 31,<br>2006 | March 31,<br>2007 |
|---|----------------------|-------------------|
|   | (In Thousands)       |                   |
| Insurance premium financing, due in installments through September 2007 (4.75%) | 433                  | 234               |
| Covenants not to compete due through August 2007 (non-interest bearing)         | 59                   | 25                |
| Vehicle Financing   | 50                   | 44                |
| Acquisition Credit Line, due September 2009 (interest rate Libor + 3.5%)        | 15,550               | 15,331            |
| Revolving Credit Line, due September 2009 (interest rate Libor + 3.5%)          | 7,400                | 9,400             |
| Senior secured notes, due 2009 (interest rate 7.66%)                            | 80,000               | 80,000            |
| <b>Total</b>  | <b>103,492</b>       | <b>105,034</b>    |
| Less current portion  | 1,388                | 1,155             |
| <b>Long-term portion</b>  | <b>\$ 102,104</b>    | <b>\$ 103,879</b> |

On September 20, 2004, concurrent with the closing of the Partnership's initial public offering, StoneMor Operating LLC and its subsidiaries issued and sold \$80.0 million aggregate principal amount of senior secured notes. The senior secured notes rank pari passu with all of our other senior secured debt, including the revolving credit facility and the acquisition facility, subject to the description of the collateral securing the senior secured notes described below. The senior secured notes are guaranteed by the Partnership, the general partner of the Partnership and any future subsidiaries of StoneMor Operating LLC. Obligations under the senior secured notes are secured by a first priority lien and security interest covering substantially all of the assets of the issuers of the senior secured notes, whether then owned or thereafter acquired, other than specified receivable rights and a third party priority lien and security interest covering those specified receivable rights, each as described above, of such issuers, whether then owned or thereafter acquired.

On September 20, 2004, concurrent with the closing of the Partnership's initial public offering, StoneMor Operating LLC and its subsidiaries entered into a new \$35.0 million credit facility with a group of banks. This credit facility consists of a \$12.5 million revolving credit line and a \$22.5 million acquisition line of credit. Borrowings under the revolving credit line were originally due and payable on September 20, 2007, and borrowings under the acquisition line of credit were originally due and payable on September 20, 2008. On September 28, 2006, the Company entered into a second amendment of the credit facility which extended the due date on both lines of credit to September 20, 2009. On May 7, 2007, the Company entered into a third amendment of the credit facility which increased the revolving credit line to \$17.5 million and reduced the acquisition line of credit to \$17.5 million. Depending on the type of loan, this credit facility bears interest at the Base Rate or the Eurodollar Rate, plus applicable margins ranging from 0.00% to 1% and 2.5% to 3.5% per annum, respectively, depending on our ratio of total debt to consolidated EBIDTA, as defined. The Base Rate is the higher of the federal funds rate plus 0.05% or the prime rate announced by Fleet National Bank, a Bank of America Company. The Eurodollar Rate is to be determined by the administrative agent according to the credit facility. As of March 31, 2007, we had outstanding borrowings of \$9.4 million under our revolving credit line. As of March 31, 2007, we had \$15.3 million outstanding under our acquisition line of credit from which we borrowed \$5.25 million for the acquisition of 22 cemeteries and 6 funeral homes from Service Corporation International in November 2005 and \$9.0 million for the acquisition of 21 cemeteries and 14 funeral homes from Service Corporation International, joined by certain of its direct and affiliated entities, in September 2006.



Borrowings under the credit facility rank pari passu with all of our other senior secured debt, including the senior secured notes, subject to the description of the collateral securing the credit facility described below. Borrowings under the credit facility are guaranteed by the Partnership and the general partner of the Partnership.

Our obligations under the revolving facility are secured by a first priority lien and security interest in specified receivable rights, whether then owned or thereafter acquired, of the borrower and the guarantors and by a third party priority lien and security interest in substantially all assets other than those receivable rights of the borrower and the guarantors, excluding trust accounts and certain proceeds required by law to be placed into such trust accounts and funds held in trust accounts, our general partner's interest in the Partnership and our general partner's incentive distribution rights under the Partnership's partnership agreement. These assets secure the acquisition facility and our senior secured notes. The specified receivable rights include all accounts and other rights to payment arising under customer contracts or agreements (other than amounts required to be deposited into merchandise and perpetual care trusts) or management agreements, and all inventory, general intangibles and other rights reasonably related to the collection and performance of these accounts and rights to payment.

Our obligations under the acquisition facility are secured by a first priority lien and security interest in substantially all assets, whether then owned or thereafter acquired, other than specified receivable rights of the borrower and the guarantors, excluding trust accounts and certain proceeds required by law to be placed into such trust accounts and funds held in trust accounts, our general partner's interest in the Partnership and our general partner's incentive distribution rights under the Partnership's partnership agreement, and a third party priority lien and security interest in those specified receivable rights of the borrower and the guarantors. The senior secured notes will share pari passu in the collateral securing the acquisition facility.

The agreements governing the revolving credit facility, the acquisition line of credit and the senior secured notes contain restrictive covenants that, among other things, prohibit distributions upon defined events of default, restrict investments and sales of assets and require us to maintain certain financial covenants, including specified financial ratios. As of March 31, 2007, the Company was in compliance with all debt covenants.

Deferred financing costs as of March 31, 2007 consisted of approximately \$2.9 million of debt issuance costs, less accumulated amortization of approximately \$1.9 million. These costs were incurred in connection with the issuance of the Company's senior secured notes during September 2004.

## 8. INCOME TAXES

As of December 31, 2006, the Company's taxable corporate subsidiaries had a federal net operating loss carryover of approximately \$40.9 million, which will begin to expire in 2019. As of December 31, 2006, the Company also had a state net operating loss carry-forward of approximately \$74.2 million, a portion of which expires annually.

Effective with the closing of the Partnership's initial public offering on September 20, 2004, the Company was no longer a taxable entity for federal and state income tax purposes; rather, the Partnership's tax attributes (except those of its corporate subsidiaries) are to be included in the individual tax returns of its partners. Neither the Partnership's financial reporting income, nor the cash distributions to unitholders, can be used as a substitute for the detailed tax calculations that the Partnership must perform annually for its partners. Net income from the Partnership is not treated as passive income for federal income tax purposes. As a result, partners subject to the passive activity loss rules are not permitted to offset income from the Partnership with passive losses from other sources.

The tax returns of the Partnership are subject to examination by state and federal tax authorities. If such examinations result in changes to taxable income, the tax liability of the partners could be changed accordingly.

The Partnership's corporate subsidiaries account for their income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The provision for income taxes for the three months ended March 31, 2006 and 2007 is based upon the estimated annual effective tax rates expected to be applicable to the Company for 2006 and 2007, respectively.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, or FIN 48, which is applicable for fiscal years beginning after December 15, 2006. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement for financial statement recognition and measurement of a tax position reported or expected to be reported on a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. On January 1, 2007, the Company adopted FIN 48. Prior to the adoption of FIN 48, the Company's policy was to recognize tax benefits of uncertain tax positions only if it was probable that the position would be sustained. FIN 48 requires application of a more likely than not threshold to the recognition and derecognition of tax positions. As a result of the adoption of FIN 48, no adjustments were made to retained earnings for unrecognized tax benefits.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. The company is not currently subject to any ongoing federal or state tax examinations. The Company has not extended the statute of limitations for the federal or state jurisdictions with tax years open from 2003 forward. The Company has tax net operating loss and credit carry forwards that are subject to examination for a number of years beyond the year in which they are utilized for tax purposes. Since a portion of these carry forwards will be utilized in the future, many of these attribute carry forwards may remain subject to examination.

At March 31, 2007, the Company had no additional amounts recorded for uncertain tax positions, interest or penalties in the accompanying consolidated financial statements.

## 9. DEFERRED CEMETERY REVENUES - NET

In accordance with SAB No. 104, the Company defers the revenues and all direct costs associated with the sale of pre-need cemetery merchandise and services until the merchandise is delivered or the services are performed. The Company also defers the costs to obtain new pre-need cemetery and new prearranged funeral business as well as the investment earnings on the prearranged services and merchandise trusts (see Note 1). At December 31, 2006 and March 31, 2007, deferred cemetery revenues, net, consisted of the following:

|  | December 31,<br>2006 | March 31,<br>2007 |
|--|----------------------|-------------------|
|  | (In Thousands)       |                   |
| Deferred cemetery revenue              | \$ 149,327           | \$ 155,496        |
| Deferred merchandise trust revenue     | 27,422               | 34,103            |
| Deferred pre-acquisition margin        | 41,954               | 41,381            |
| Deferred cost of good sold             | (22,600)             | (23,479)          |
| <b>Deferred cemetery revenues, net</b> | <b>\$ 196,103</b>    | <b>\$ 207,501</b> |
| Deferred selling and obtaining costs   | \$ 33,478            | \$ 34,996         |

Deferred selling and obtaining costs are carried as an asset on the condensed consolidated balance sheet in accordance with FAS 60.

## 10. COMMITMENTS AND CONTINGENCIES

**Legal** The Company is party to legal proceedings in the ordinary course of its business but does not expect the outcome of any proceedings, individually or in the aggregate, to have a material adverse effect on the Company's financial position, results of operations or liquidity.

**Leases** At March 31, 2007, the Company was committed to operating lease payments for premises, automobiles and office equipment under various operating leases with initial terms ranging from one to five years and options to renew at varying terms. Expenses under operating leases were \$0.2 million for the three months ended March 31, 2007 and \$0.4 million for the three months ended March 31, 2006.

At March 31, 2007, operating leases will result in future payments in the following approximate amounts:

|              | (in thousands)  |
|--------------|-----------------|
| 2007         | \$ 541          |
| 2008         | 627             |
| 2009         | 600             |
| 2010         | 484             |
| 2011         | 426             |
| Thereafter   | 879             |
| <b>Total</b> | <b>\$ 3,557</b> |

**Tax Indemnification** CFSI LLC (formerly Cornerstone Family Services, Inc., the Company's predecessor) has agreed to indemnify the Company for all federal, state and local income tax liabilities attributable to the operation of the assets contributed by CFSI LLC to us prior to September 20, 2004. CFSI LLC has also agreed to indemnify us against additional income tax liabilities, if any, that arise from the consummation of the transactions related to our formation in excess of those believed to result at the time of the closing of our initial public offering. CFSI LLC has also agreed to indemnify us against the increase in income tax liabilities of our corporate subsidiaries resulting from any reduction or elimination of our net operating losses to the extent those net operating losses are used to offset any income tax gain or income resulting from the prior operation of the assets of CFSI LLC contributed to us, or from our formation transactions in excess of such gain or income believed to result at September 20, 2004.

## 11. STOCKHOLDERS EQUITY

### *Share-Based Compensation*

Compensation expense recognized related to unit appreciation rights and restricted phantom unit awards is summarized in the table below:

| (in thousands)                                | Three Months Ended March 31, |                 |
|---|------------------------------|-----------------|
|   | 2006                         | 2007            |
| Unit appreciation rights                      | \$ 0                         | \$ 43           |
| Restricted phantom units                      | 0                            | 1,115           |
| <b>Total share-based compensation expense</b> | <b>\$ 0</b>                  | <b>\$ 1,158</b> |

As of March 31, 2007, there was \$0.2 million and \$5.8 million of unrecognized pretax compensation cost related to nonvested unit appreciation rights and nonvested restricted phantom units, respectively.

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The words we, us, our, StoneMor, the Partnership, Company and similar words, when used in a historical context prior to the closing of the initial public offering of StoneMor Partners L.P. on September 20, 2004, refer to Cornerstone Family Services, Inc. (Cornerstone) (and, after its conversion, CFSI LLC) and its subsidiaries and thereafter refer to StoneMor Partners L.P. and its subsidiaries.

This discussion and analysis should be read in conjunction with our unaudited condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q (including the notes thereto).

### **Forward-Looking Statements**

Certain statements contained in this Quarterly Report on Form 10-Q, including, but not limited to, information regarding the status and progress of StoneMor's operating activities, the plans and objectives of StoneMor's management, assumptions regarding StoneMor's future performance and plans, and any financial guidance provided, as well as certain information in other filings with the SEC and elsewhere, are forward-looking statements within the meaning of Section 27A(i) of the Securities Act of 1933 and Section 21E(i) of the Securities Exchange Act of 1934. The



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words believe, may, will, estimate, continues, anticipate, intend, project, expect predict, and similar expressions identify these statements. These forward-looking statements are made subject to certain risks and uncertainties that could cause actual results to differ materially from those stated,

including, but not limited to, the following: future revenue and revenue growth; the impact of StoneMor's significant leverage on its operating plans; the ability of StoneMor to service its debt; StoneMor's ability to attract, train and retain an adequate number of sales people; uncertainties associated with the volume and timing of pre-need sales of cemetery services and products; variances in death rates; variances in the use of cremation; changes in the political or regulatory environments, including potential changes in tax accounting and trusting policies; StoneMor's ability to successfully implement a strategic plan relating to producing operating improvement, strong cash flows and further deleveraging; uncertainties associated with the integration or the anticipated benefits of the acquisition of assets in September 2006, information disclosed within this Quarterly Report on Form 10-Q; and various other uncertainties associated with the deathcare industry and StoneMor's operations in particular.

When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006. We assume no obligation to publicly update or revise any forward-looking statements made herein or any other forward-looking statements made by us, whether as a result of new information, future events or otherwise.

## Overview

On April 2, 2004, StoneMor Partners L.P. ( StoneMor , the Partnership , or the Company ) was created to own and operate the cemetery and funeral home business conducted by Cornerstone Family Services, Inc. ( Cornerstone ) and its subsidiaries. On September 20, 2004, in connection with the initial public offering by the Partnership of common units representing limited partner interests, Cornerstone contributed to the Partnership substantially all of the assets, liabilities and businesses owned and operated by it, and then converted into CFSI LLC, a limited liability company. This transfer represented a reorganization of entities under common control and was recorded at historical cost. In exchange for these assets, liabilities and businesses, CFSI LLC received 564,782 common units and 4,239,782 subordinated units representing limited partner interests in the Partnership.

Cornerstone was founded in 1999 by members of our management team and a private equity investment firm, which we refer to as McCown De Leeuw, in order to acquire a group of 123 cemetery properties and 4 funeral homes. Since that time, Cornerstone, succeeded by StoneMor, acquired 54 additional cemeteries and 22 funeral homes, built two funeral homes and sold one cemetery and one funeral home.

On September 20, 2004, StoneMor completed its initial public offering of 3,675,000 common units at a price of \$20.50 per unit representing a 42.5% interest in us. On September 23, 2004, StoneMor sold an additional 551,250 common units to the underwriters in connection with the exercise of their over-allotment option and redeemed an equal number of common units from CFSI LLC at a cost of \$5.3 million, making a total of 4,239,782 common units outstanding. Total gross proceeds from these sales were \$86.6 million, before offering costs and underwriting discounts. The net proceeds to the Partnership, after deducting underwriting discounts but before paying offering costs, from these sales of common units was \$80.8 million. Concurrent with the initial public offering, the Partnership's wholly owned subsidiary, StoneMor Operating LLC, and its subsidiaries, all as borrowers, issued and sold \$80.0 million in aggregate principal amount of senior secured notes in a private placement and entered into a \$12.5 million revolving credit facility and a \$22.5 million acquisition facility with a group of banks. The net proceeds of the initial public offering and the sale of senior secured notes were used to repay the debt and associated accrued interest of approximately \$135.1 million of CFSI LLC and \$15.7 million of fees and expenses associated with the initial public offering and the sale of senior secured notes. The remaining funds have been used for general partnership purposes, including the construction of mausoleum crypts and lawn crypts, the purchases of equipment needed to install burial vaults and the acquisition of cemetery and funeral home locations.

We are an owner and operator of cemeteries in the United States of America. As of March 31, 2007, the Company operated 176 cemeteries in 20 states, located primarily in the eastern United States of America. The Company owns 170 of these cemeteries and operates the remaining 6 under long-term management agreements with cemetery associations that own the cemeteries. As a result of the agreements and other control arrangements, StoneMor consolidates the results of the 6 managed cemeteries in our historical consolidated financial statements.

StoneMor sells cemetery products and services both at the time of death, which the Company refers to as at-need, and prior to the time of death, which the Company refers to as pre-need. During the first three months of 2007, StoneMor performed over 7,600 burials and sold more than 5,700 interment rights (net of cancellations) compared to 6,300 and 3,400, respectively, for the same period of 2006.

*Cemetery Operations*

*Sources of Revenues.* Our results of operations are determined primarily by the volume of sales of products and services and the timing of product delivery and performance of services. We derive our revenues primarily from:

at-need sales of cemetery interment rights, merchandise and services, which we recognize as revenues at the time of sale;

pre-need sales of cemetery interment rights, which we generally recognize as revenues when we have collected 10% of the sales price from the customer;

pre-need sales of cemetery merchandise, which we recognize as revenues when we satisfy the criteria specified below for delivery of the merchandise to the customer;

pre-need sales of cemetery services, other than perpetual care services, which we recognize as revenues when we perform the services for the customer;

accumulated merchandise trust earnings related to the delivery of pre-need cemetery merchandise and the performance of pre-need cemetery services, which we recognize as revenues when we deliver the merchandise or perform the services;

income from perpetual care trusts, which we recognize as revenues as the income is earned in the trust; and

other items, such as interest income on pre-need installment contracts and sales of land.

Revenues from pre-need sales of cemetery merchandise and the related accumulated merchandise trust earnings are deferred until the merchandise is delivered to the customer, which generally means that:

the merchandise is complete and ready for installation or, in the case of merchandise other than burial vaults, storage on third-party premises;

the merchandise is either installed or stored at an off-site location, at no additional cost to us, and specifically identified with a particular customer, except as described below; and

the risks and rewards of ownership have passed to the customer.

We generally satisfy these delivery criteria by purchasing the merchandise and either installing it on our cemetery property or storing it, at the customer's request, in third-party warehouses, at no additional cost to us, until the time of need. With respect to burial vaults, we install the vaults rather than storing them to satisfy the delivery criteria. When merchandise is stored for a customer, we may issue a certificate of ownership to the customer to evidence the transfer to the customer of the risks and rewards of ownership.

*Deferred Cemetery Revenues, Net.* Deferred revenues from pre-need sales and related merchandise trust earnings are reflected on our balance sheet in deferred cemetery revenues, net, until we recognize the amounts as revenues. Deferred cemetery revenues, net, also includes deferred revenues from pre-need sales that were entered into by entities we acquired prior to the time we acquired them. These entities include those that we acquired at the time of the formation of Cornerstone and other entities we subsequently acquired. We recognize revenues from these acquired pre-need sales in the manner described above—that is, when we deliver the merchandise to, or perform the services for, the customer. Our profit margin on these pre-need sales is generally less than our profit margin on other pre-need sales because, in accordance with industry practice at

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the time these acquired pre-need sales were made, none of the selling expenses were recognized at the time of sale. As a result, we are required to recognize all of the expenses (including deferred selling expenses) associated with these acquired pre-need sales when we recognize the revenues from that sale. We recognize certain expenses, such as indirect selling costs, maintenance costs and general and administrative costs, at the time the pre-need sale is made and defer other expenses, such as direct selling costs and costs of goods sold, until we recognize revenues on the sale. As a result, our profit margin on current pre-need sales is generally higher than on the pre-need sales we acquired.

### *Funeral Home Operations*

We also derive revenues from the sale of funeral home merchandise, including caskets and related funeral merchandise, and services, including removal and preparation of remains, the use of our facilities for visitation, worship and performance of funeral services and transportation services. These services and merchandise are sold by us almost exclusively at the time of need by salaried licensed funeral directors.

We generally include revenues from pre-need casket sales in the results of our cemetery operations. However, some states require that caskets be sold by funeral homes, and revenues from casket sales in those states are included in our funeral home results. We do not report the results of our funeral home operations as a separate business segment.

### Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on the historical consolidated financial statements of StoneMor. We prepared these financial statements in conformity with Accounting Principles Generally Accepted in the United States of America. The preparation of these financial statements required us to make estimates, judgments and assumptions that affected the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We based our estimates, judgments and assumptions on historical experience and known facts and other assumptions that we believed to be reasonable under the circumstances. In future periods, we expect to make similar estimates, judgments and assumptions on the same basis as we have historically. Our actual results in future periods may differ from these estimates under different assumptions and conditions. We believe that the following accounting policies or estimates had or will have the greatest potential impact on our consolidated financial statements for the periods discussed and for future periods.

*Revenue Recognition.* At-need sales of cemetery interment rights, merchandise and services and at-need sales of funeral home merchandise and services are recognized as revenues when the interment rights or merchandise is delivered or the services are performed.

Revenues from pre-need sales of cemetery interment rights in constructed burial property are deferred until at least 10% of the sales price has been collected. Revenues from pre-need sales of cemetery interment rights in unconstructed burial property, such as mausoleum crypts and lawn crypts, are deferred until at least 10% of the sales price has been collected, at which time revenues are recognized using the percentage-of-completion method of accounting. The percentage-of-completion method of accounting requires us to estimate the percentage of completion as of the balance sheet date and future costs (including estimates for future inflation). Changes to our estimates of the percentage of completion or the related future costs would impact the amount of recognized and deferred revenues.

Revenues from pre-need sales of cemetery merchandise and services are deferred until the merchandise is delivered or the services are performed. Investment earnings generated by funds required to be deposited into merchandise trusts, including realized gains and losses, in connection with pre-need sales of cemetery merchandise and services are deferred until the associated merchandise is delivered or the services are performed.

We defer recognition of the direct costs associated with pre-need sales of cemetery products and services. Direct costs are those costs that vary with and are directly related to obtaining new pre-need cemetery business and the actual cost of the products and services we sell. Direct costs are expensed when the related revenues are recognized. Until that time, direct costs are reflected on our balance sheet in deferred cemetery revenues, net.

*Allowance for Cancellations.* Allowances for cancellations arising from non-payment of pre-need contracts are estimated at the date of sale based upon our historical cancellation experience. Due to the number of estimates and projections used in determining an expected cancellation rate and the possibility of changes in collection patterns resulting from modifications to our collection policies or contract terms, actual collections could differ from these estimates.

*Impairment of Long-Lived Assets.* We monitor the recoverability of long-lived assets, including cemetery property, property and equipment, merchandise and perpetual care trusts, and other assets, based on estimates using factors such as current market value, future asset utilization, business and regulatory climate and future undiscounted cash flows expected to result from the use of the related assets. Our policy is to record an impairment loss in the period when it is determined that the sum of future undiscounted cash flows is less than the carrying value of the asset. Modifications to our estimates could result in our recording impairment charges in future periods.

*Property and Equipment.* Property and equipment is recorded at cost and depreciated on a straight-line basis. Maintenance and repairs are charged to expense as incurred, whereas additions and major replacements are capitalized and depreciated over the estimated useful life of the asset. We estimate that the useful lives of our buildings and improvements are 10 to 40 years, that the useful lives of our furniture and equipment are 5 to 10 years and that the useful lives of our leasehold improvements are the respective terms of the leases. These estimates could be impacted in the future by changes in market conditions or other factors.

*Income Taxes.* We make estimates and judgments to calculate some of our tax liabilities and determine the recoverability of some of our deferred tax assets, which arise from temporary differences between the tax and financial statement recognition of revenues and expenses. We also estimate a reserve for deferred tax assets if, based on the available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods.

In evaluating our ability to recover deferred tax assets, we consider all available positive and negative evidence, including our past operating results, recent cumulative losses and our forecast of future taxable income. In determining future taxable income, we make assumptions for the amount of taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require us to make judgments about our future taxable income and are consistent with the plans and estimates we use to manage our business. Any reduction in estimated future taxable income may require us to record an additional valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in the period and could have a significant impact on our future earnings.

We expect to reduce the amount of our taxable income as a result of our treatment as a partnership for U.S. federal tax purposes. However, some of our operations will be continue to be conducted through corporate subsidiaries that will be subject to applicable U.S. federal and state income taxes. Accordingly, changes in our income tax plans and estimates may impact our earnings in future periods.

As of December 31, 2006, the Company's taxable corporate subsidiaries had a federal net operating loss carryover of approximately \$40.9 million, which will begin to expire in 2019. As of December 31, 2006, the Company also had a state net operating loss carry-forward of approximately \$74.2 million, a portion of which expires annually. Our ability to use such federal net operating losses may be limited by changes in the ownership of our units deemed to result in an ownership change under the applicable provisions of the Internal Revenue Code.

For additional information about, among other things, our pre-need sales, at-need sales, trusting requirements, cash flow, expenses and operations, please see Management's Discussion and Analysis of Financial Condition and Results of Operations included in our annual report on Form 10-K for the fiscal year ended December 31, 2006 and our other reports and statements filed with the SEC.

#### **Recent Accounting Pronouncements**

Effective January 1, 2006, the Company adopted SFAS No. 123R, which replaces FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123) and supercedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. Prior to January 1, 2006, the Company did not have any outstanding stock-based employee compensation plans.

In July 2006, the Financial Accounting Standards Board issued FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109*. Interpretation 48, which clarifies Statement 109, *Accounting for Income Taxes*, establishes the criterion that an individual tax position has to meet for some or all of the benefits of that position to be recognized in the Company's financial statements. On initial application, Interpretation 48 will be applied to all tax positions for which the statute of limitations remains open. Only tax positions that meet the more-likely-than-not recognition threshold at the adoption date will be recognized or continue to be recognized. The cumulative effect of applying Interpretation 48 will be reported as an adjustment to retained earnings at the beginning of the period in which it is adopted. Interpretation 48 is effective for fiscal years beginning after December 15, 2006. The adoption of Interpretation 48 did not have a significant effect on the Company's financial statements or its ability to comply with its current debt covenants.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( FAS 157 ). FAS 157 defines fair value, establishes a market-based framework or hierarchy for measuring fair value, and expands disclosures about fair value measurements. FAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. FAS 157 does not expand or require any new fair value measures, however the application of this statement may change current practice. The requirements of FAS 157 are effective for our fiscal year beginning January 1, 2008. We are in the process of evaluating this guidance and therefore have not yet determined the impact that FAS 157 will have on our financial statements upon adoption.

In September 2006, the SEC released SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ( SAB 108 ), which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The provisions of SAB 108 became effective beginning November 15, 2006. The impact of SAB 108 in the future depends on the nature and extent of any prior year misstatements. The Company utilized the guidance in SAB 108 to determine the effect of the prior year misstatement.

In February 2007, the FASB issued SFAS No. 159, *Establishing the Fair Value Option for Financial Assets and Liabilities*, to permit all entities to choose to elect to measure eligible financial instruments at fair value. SFAS No. 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS No. 157, *Fair Value Measurements*. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. The Company is currently evaluating the impact of SFAS No. 159 on the consolidated financial statements.

**Results of Operations**

The following table summarizes our results of operations for the periods presented:

|                                      | <b>Three months ended March 31,</b> |                 |
|--------------------------------------|-------------------------------------|-----------------|
|                                      | <b>2006</b>                         | <b>2007</b>     |
|                                      | <b>(in thousands)</b>               |                 |
| <b>Statement of Operations Data:</b> |                                     |                 |
| Revenues:                            |                                     |                 |
| Cemetery                             | \$ 25,192                           | \$ 27,510       |
| Funeral home                         | 1,460                               | 3,030           |
| <b>Total</b>                         | <b>26,652</b>                       | <b>30,540</b>   |
| Costs and Expenses:                  |                                     |                 |
| Cost of goods sold:                  |                                     |                 |
| Land and crypts                      | 1,447                               | 1,289           |
| Perpetual care                       | 736                                 | 888             |
| Merchandise                          | 1,273                               | 1,727           |
| Cemetery expense                     | 5,636                               | 6,784           |
| Selling expense                      | 5,647                               | 6,244           |
| General and administrative expense   | 3,064                               | 3,738           |
| Corporate overhead                   | 3,808                               | 5,282           |
| Depreciation and amortization        | 821                                 | 874             |
| Funeral home expense                 | 1,093                               | 2,103           |
| Interest expense                     | 1,733                               | 2,046           |
| Income taxes                         | 453                                 | 216             |
| <b>Net income (loss)</b>             | <b>\$ 941</b>                       | <b>\$ (651)</b> |



The following table presents supplemental operating data as of the periods presented:

|   | Three months ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2006                            | 2007       |
| <b>Operating Data:</b>  |                                 |            |
| Interments Performed  | 6,372                           | 7,640      |
| Cemetery revenues per interment performed                             | \$ 3,947                        | \$ 3,601   |
| Interment rights sold (1):  |                                 |            |
| Lots  | 2,135                           | 4,807      |
| Mausoleum crypts (including pre-construction)                         | 566                             | 705        |
| Niches  | 116                             | 146        |
| <br>Total interment rights sold                                       | <br>2,817                       | <br>5,658  |
| <br>Number of contracts written                                       | <br>13,231                      | <br>15,278 |
| Aggregate contract amount, in thousands (excluding interest)          | \$ 28,128                       | \$ 33,307  |
| Average amount per contract (excluding interest)                      | \$ 2,126                        | \$ 2,180   |
| <br>Number of pre-need contracts written                              | <br>6,242                       | <br>6,845  |
| Aggregate pre-need contract amount, in thousands (excluding interest) | \$ 18,254                       | \$ 21,113  |
| Average amount per pre-need contract (excluding interest)             | \$ 2,924                        | \$ 3,084   |
| <br>Number of at-need contracts written                               | <br>6,989                       | <br>8,433  |
| Aggregate at-need contract amount, in thousands                       | \$ 9,874                        | \$ 12,174  |
| Average amount per at-need contract                                   | \$ 1,413                        | \$ 1,444   |

(1) Net of cancellations. Counts the sale of a double-depth burial lot as the sale of two interment rights.

**Three Months Ended March 31, 2007 Compared to Three Months Ended March 31, 2006**

*Cemetery Revenues.* Cemetery revenues were \$27.5 million in the first quarter of 2007, an increase of \$2.3 million, or 9.1%, as compared to \$25.2 million in the first quarter of 2006. Cemetery revenues from pre-need sales, including interest income from pre-need installment contracts and investment income from trusts, were \$16.0 million in the first quarter of 2007, an increase of \$1.2 million, or 8.1%, as compared to \$14.8 million in the first quarter of 2006. The increase primarily resulted from increased lot sales (\$0.2 million) and additional vault casket deliveries (\$0.7 million), offset by a decrease in marker and marker base deliveries of \$0.3 million. Total revenues from merchandise and perpetual care trusts for the first quarter of 2007 were \$3.4 million, an increase of \$0.6 million or 21.4%, as compared to \$2.8 million during the same period in 2006.

Cemetery revenues from at-need sales in the first quarter of 2007 were \$11.2 million, an increase of \$2.0 million, or 21.7%, as compared to \$9.2 million in the first quarter of 2006. The increase in cemetery revenues from at-need sales was primarily attributable to higher sales of openings and closings of \$0.8 million, higher sales of monument bases and markers of \$0.6 million, higher sales of lots of \$0.2 million, higher sales of mausoleums of \$0.2 million and higher sales of vaults of \$0.2 million.

Other cemetery revenues were \$0.3 million in the first quarter of 2007, a decrease of \$0.4 million or 57.1%, as compared to \$0.7 million in the first quarter of 2006. The decrease is related to a decrease in excess land sold of \$0.5 million during the quarter as compared to the same quarter last year.

The first quarter increases in almost all revenue components are primarily related to our acquisition of 21 cemeteries and 14 funeral homes from Service Corporation International in September 2006.

*Costs of Goods Sold.* Cost of goods sold was \$3.9 million in the first quarter of 2007, an increase of \$0.4 million, or 11.4%, as compared to \$3.5 million in the first quarter of 2006 due to the composition of the items serviced during the period. As a percentage of cemetery revenues, cost of goods sold was 14.2% in the first quarter of 2007 an increase of 0.3% from 13.9% in the first quarter of 2006.

*Cemetery Expense.* Total selling expense was \$6.8 million in the first quarter of 2007, an increase of \$1.2 million, or 21.4%, as compared to \$5.6 million in the first quarter of 2006. Sales commissions and other compensation expenses contributed \$4.8 million to total selling expense during the first quarter of 2007, an increase of \$0.4 million, or 8.3%, compared to \$4.4 million in the first quarter of 2006. As a percentage of pre-need sales, sales commissions and other compensation expenses were 30.0% in the first quarter of 2007, an increase of 0.3% from the first quarter of 2006.

*Selling Expense.* Cemetery expense was \$6.2 million in the first quarter of 2007, an increase of \$0.6 million, or 10.7%, as compared to \$5.6 million in the first quarter of 2006. This increase was primarily due to an increase in cemetery labor costs of \$0.6 million.

*General and Administrative Expense.* General and administrative expense was \$3.7 million in the first quarter of 2007, an increase of \$0.6 million, or 19.4%, as compared to \$3.1 million in the first quarter of 2006. The increase was primarily attributable to an increase in office salaries of \$0.3 million and an increase in insurance costs of \$0.2 million.

*Funeral Home Revenues and Expense.* Funeral home revenues were \$3.0 million in the first quarter of 2007, an increase of \$1.5 million, or 100.0%, as compared to \$1.5 million in the first quarter of 2006. The primary reason for the increase was an increase in the number of services performed, 866 in the first quarter of 2007 compared to 342 in the first quarter of 2006. Funeral home expenses were \$2.1 million in the first quarter of 2007, an increase of \$1.0 million, or 90.9%, as compared to \$1.1 million in the first quarter of 2006. The majority of all increases in funeral home revenue and expenses are attributable to our acquisition of 21 cemeteries and 14 funeral homes from Service Corporation International in September 2006.

*Corporate Overhead.* Corporate overhead was \$5.3 million in the first quarter of 2007, an increase of \$1.5 million, or 39.5%, as compared to \$3.8 million in the first quarter of 2006. The increase was primarily attributable to \$1.2 million in additional non-cash expenses resulting from a grant of stock-based compensation under our Long-Term Incentive Plan program in November of 2006 which will be expensed over the vesting term in accordance with FAS 123R.

*Depreciation and Amortization.* Depreciation and amortization was \$0.9 million in the first quarter of 2007, essentially unchanged from the first quarter of 2006.

*Interest Expense.* Interest expense was \$2.0 million in the first quarter of 2007, an increase of \$0.3 million, or 17.6%, as compared to \$1.7 million in the first quarter of 2006. This increase is attributable to \$16.2 million increase in debt outstanding at March 31, 2007.

*Provision (Benefit) for Income Taxes.* Provision for income taxes was \$0.2 million in the first quarter of 2007 as compared to a provision for income taxes of \$0.5 million during the first quarter of 2006. The change in provision for income taxes was primarily due to the decrease in operating profit at our non-qualified locations attained during the first quarter of 2007.

*Net Income(Loss).* Net loss was \$0.7 million during the first quarter of 2007, a decrease of \$1.6 million, or 177.8%, as compared to a net income of \$0.9 million during the first quarter of 2006. The increase was primarily attributable to \$1.2 million in additional non-cash expenses resulting from an equity grant under our Long-Term Incentive Plan in November of 2006 and increased fixed expenses related to the properties we acquired in September 2006 that were not fully integrated into our system as of the end of the quarter.

*Deferred Cemetery Revenue, net.* Deferred cemetery revenues, net, increased \$11.4 million, or 5.8% in the first quarter of 2007, from \$196.1 million as of December 31, 2006 to \$207.5 million as of March 31, 2007. In the comparable period in 2006, deferred cemetery revenues, net, increased \$5.2 million, or 3.1%, from \$167.8 million as of December 31, 2005 to \$173.0 million as of March 31, 2006. The net increase in the quarter ended March 31, 2007 was primarily attributable to an increase in sales of pre-need cemetery products and services that were not delivered or performed in the quarter ended March 31, 2007 and our September 2006 acquisition. In the three months ended March 31, 2007, we added \$20.1 million in pre-need sales of cemetery merchandise and services, net of deferred costs and cancellations, to our pre-need sales backlog which was offset by revenues recognized, net of costs,

of \$8.9 million, including accumulated merchandise trust earnings related to the delivery and performance of pre-need cemetery merchandise and services. In the three months ended March 31, 2006, we added \$14.5 million in pre-need sales of cemetery merchandise and services, net of deferred costs and cancellations, to our pre-need sales backlog which was offset by revenues recognized, net of costs, of \$9.0 million, including accumulated merchandise trust earnings related to the delivery and performance of pre-need cemetery merchandise and services.

### **Liquidity and Capital Resources**

*Overview.* Our primary short-term operating liquidity needs are to fund general working capital requirements and maintenance capital expenditures. Our long-term operating liquidity needs are primarily associated with acquisitions of cemetery properties and the construction of mausoleum crypts and lawn crypts on the grounds of our cemetery properties. We may also construct funeral homes on the grounds of cemetery properties that we acquire in the future. Our primary source of funds for our short-term liquidity needs are cash flow from operations and income from perpetual care trusts. Our primary source of funds for long-term liquidity needs are long-term bank borrowings and the issuance of additional common units and other partnership securities, including debt, subject to the restrictions in our credit facility and under our senior secured notes.

We believe that cash generated from operations and our borrowing capacity under our credit facility, which is discussed below, will be sufficient to meet our working capital requirements, anticipated capital expenditures and scheduled debt payments for the foreseeable future. In 2007, we anticipate that we will spend \$2.8 million for the construction of mausoleums. Additionally, we anticipate ongoing annual capital expenditure requirements of between approximately \$1.7 million and \$2.9 million for the foreseeable future, of which between \$1.1 million and \$2.1 million is for maintenance of our existing cemeteries and between \$0.6 million and 0.8 million is for mausoleum and lawn crypt construction and other expansion, excluding acquisitions. The estimate for cemetery maintenance capital expenditures would increase if we were to acquire additional cemetery properties.

One of our goals is to grow through the acquisition of high-quality cemetery properties. On November 1, 2005, StoneMor acquired 22 cemeteries and six funeral homes from Service Corporation International (NYSE: SCI) for \$12.93 million. StoneMor paid \$7.03 million in cash and 280,952 StoneMor common units representing limited partner interests, representing the additional \$5.9 million. In addition, StoneMor assumed the merchandise and service liabilities associated with certain pre-arranged bonded contracts related to the properties. Additionally, on September 28, 2006, we completed the acquisition of 21 cemeteries and 14 funeral homes from Service Corporation International (NYSE: SCI) and its affiliates for \$11.8 million. We paid \$5.9 million in cash and 275,046 in common units representing limited partner interests, representing the additional \$5.9 million. We acquired two additional cemeteries during the fourth quarter of 2006 with an aggregate purchase price of approximately \$1.3 million.

Our ability to satisfy our debt service obligations, fund planned capital expenditures, make acquisitions and pay distributions to partners will depend upon our future operating performance. Our operating performance is primarily dependent on the sales volume of customer contracts, the cost of purchasing cemetery merchandise that we have sold, the amount of funds withdrawn from merchandise trusts and perpetual care trusts and the timing and amount of collections on our pre-need installment contracts.

*Cash Flow from Operating Activities.* Cash flows provided by operating activities were \$1.4 million in the first three months of 2007 compared to cash flows provided by operating activities of \$2.6 million during the first three months of 2006. Cash flows provided by operating activities in the first three months of 2007 decreased from the cash flows provided by operating activities in the first three months of 2006 primarily due to an increase in accounts receivable which is associated with increases in sales of pre-need contracts that we entered into during the quarter. Additionally, we recognized a net loss in the first three months of 2007 as compared to net income in the first three months of 2006. This decrease in cash flows from operating activities was partially offset by an increase in deferred revenue. Additionally, we used approximately \$2.4 million in additional cash to reduce our outstanding accounts payable and accrued liabilities.

*Cash Flow from Investing Activities.* Net cash used in investing activities was \$1.7 million in the first three months of 2007, an increase of \$2.0 million, as compared to cash provided investing activities of \$0.3 million in the first three months of 2006. This increase in cash used in investing activities was primarily attributable to the \$2.1 million sale of one of our funeral homes in the first three months of 2006. We did not sell any locations in the first three months of 2007.

*Cash Flow from Financing Activities.* Net cash used in financing activities was \$3.1 million in the first three months of 2007 as compared to cash used in financing activities of \$3.1 million in the first three months of 2006. The cash flow used in financing

activities in the first quarter of 2007 was primarily attributable to the February unit holder distributions of \$4.6 million offset by increased net borrowings from our long-term debt facilities of \$1.5 million. The cash flow used in financing activities in the first quarter of 2006 was primarily attributable to the February unit holder distributions of \$4.2 million partially offset by increased borrowings from our revolving credit facility of \$1.1 million.

*Credit Facility.* Concurrent with the closing of our initial public offering in September 2004, StoneMor Operating LLC, which is our operating company, and its present and future subsidiaries, all as borrowers, entered into a new \$35.0 million credit agreement. The credit agreement consists of a \$12.5 million revolving credit facility and a \$22.5 million acquisition line of credit. Borrowings under our revolving credit facility were originally due and payable three years after the date of the credit agreement, and borrowings under the acquisition facility were originally due and payable four years after the date of the credit agreement. On September 28, 2006, we entered into a second amendment to the credit agreement which extended the due date on both credit lines to September 20, 2009. On May 7, 2007, we entered into a third amendment of the credit facility which increased the revolving credit line to \$17.5 million and reduced the acquisition line of credit to \$17.5 million. We may prepay all loans under the credit agreement at any time without penalty, although our acquisition line may be subject to hedging arrangements with attendant termination fees. Any amounts repaid on the acquisition line cannot be reborrowed. We are required to reduce borrowings under our revolving credit facility that are designated for the purpose of funding a regularly scheduled quarterly distribution to the unitholders to not more than \$5.0 million for a period of at least 30 consecutive days at least once during each consecutive 12-month period prior to the maturity of the revolving credit facility. As of March 31, 2007, we had outstanding borrowings of \$9.4 million under our revolving credit line. As of March 31, 2007, we had \$15.3 million outstanding under our acquisition line of credit from which we borrowed \$5.25 million for the acquisition of 22 cemeteries and 6 funeral homes from Service Corporation International in November 2005 and \$9.0 million for the acquisition of 21 cemeteries and 14 funeral homes from Service Corporation International, joined by certain of its affiliated entities, in September 2006.

The revolving credit facility is available for ongoing working capital needs, capital expenditures, distributions and general partnership purposes. Amounts borrowed and repaid under the revolving credit facility may be borrowed in an amount that does not exceed 80% of our eligible accounts receivable. Eligible accounts receivable are defined as gross accounts receivable represented by approved installment agreements for pre-need sales net of collection reserves, imputed interest earnings, funds due to perpetual care and merchandise trusts, unpaid sales commissions and other reserves as may be required by the agent for the lenders.

The acquisition facility is available to finance acquisitions of companies in our line of business that have been approved by our board of directors. We are required to obtain the approval of the requisite lenders for any acquisition exceeding \$2.5 million and for any series of acquisitions exceeding \$20.0 million in any consecutive 12 months, but this consent may not be unreasonably withheld. Interest under the acquisition facility is payable quarterly for the first 12 months after each borrowing. We will repay the then outstanding borrowings in equal quarterly installments based on a six-year amortization schedule, with the first quarterly principal payment beginning 15 months after each borrowing and subsequent quarterly principal payments continuing on each 3 month interval from the previous quarterly principal payment and with a balloon payment for any unpaid amount due at the maturity of the acquisition facility.

Borrowings under the credit agreement rank *pari passu* with all of our other senior secured debt, including the senior secured notes issued concurrently with our initial public offering, subject to the description of the collateral securing the credit agreement described below. Borrowings under the credit agreement are guaranteed by the partnership and our general partner.

Our obligations under the revolving facility are secured by a first priority lien and security interest in specified receivable rights, whether then owned or thereafter acquired, of the borrowers and the guarantors and by a first priority lien and security interest in substantially all assets other than those receivable rights of the borrowers and the guarantors, excluding trust accounts and certain proceeds required by law to be placed into such trust accounts and funds held in trust accounts, our general partner's general partner interest in the partnership and our general partner's incentive distribution rights under our partnership agreement. These assets will secure the acquisition facility and our senior secured notes, as described below under *Senior Secured Notes*. The specified receivable rights include all accounts and other rights to payment arising under customer contracts or agreements (other than amounts required to be deposited into merchandise and perpetual care trusts) or management agreements, and all inventory, general intangibles and other rights reasonably related to the collection and performance of these accounts and rights to payment.

Our obligations under the acquisition facility are secured by a first priority lien and security interest in substantially all assets, whether then owned or thereafter acquired, other than specified receivable rights of the borrowers and the guarantors, excluding trust accounts and certain proceeds required by law to be placed into such trust accounts and funds held in trust accounts, our general partner's general partner interest in the partnership and our general partner's incentive distribution rights under our partnership agreement, and a third party priority lien and security interest in those specified receivable rights of the borrowers and the guarantors. The senior secured notes will share *pari passu* in the collateral securing the acquisition facility.

Depending on the type of loan, indebtedness outstanding under the revolving credit facility bears interest at a rate based upon the Base Rate or the Eurodollar Rate plus an applicable margin ranging from 0.00% to 1.00% and 2.50% to 3.50% per annum, respectively, depending on our ratio of total debt to consolidated cash flow. The Base Rate is the higher of the federal funds rate plus .050% or the prime rate announced by Fleet National Bank, a Bank of America company. The Eurodollar Rate is to be determined by the administrative agent according to the new credit agreement. The interest will be determined and payable quarterly. We incur commitment fees ranging from 0.375% to 0.500% per annum, depending on our ratio of total debt to consolidated cash flow, determined and payable quarterly based on the unused amount of the credit facilities.

We are required to use the net cash proceeds from the sale of any assets, the incurrence of any indebtedness or the issuance of any equity interests in the partnership or any subsidiary of the partnership to repay amounts outstanding under the credit agreement and our senior secured notes, pro rata based on the percentage share of the aggregate amounts outstanding, provided that we may use the proceeds from the sale of any assets to purchase capital assets or fund permitted acquisitions within 180 days of such sale and we may use the proceeds from any issuance of equity interests by the partnership to fund permitted acquisitions to the extent such equity interests are issued in connection with a permitted acquisition that is completed within 180 days before or after the receipt of such proceeds.

The credit agreement prevents us from declaring dividends or distributions if any event of default, as defined in the new credit agreement, occurs or would result from such declaration. The following will be an event of default under the credit agreement:

failure to pay any principal, interest, fees, expenses or other amounts when due;

failure of any of our representations and warranties to be materially correct;

failure to observe any covenant included in the credit agreement beyond specified cure periods in specified cases;

the occurrence of a default under other indebtedness of the partnership, our general partner, our operating company or any of our other subsidiaries;

the occurrence of specified bankruptcy or insolvency events involving the partnership, our operating company, our general partner or our other subsidiaries;

a change of control; or

the entry of judgments against the partnership, our general partner, our operating company or any of our other subsidiaries in excess of certain allowances.

Change of control is defined in the credit agreement as the occurrence of any of the following events:

any two of our chairman, chief executive officer or chief financial officer on the date of the credit agreement cease to hold such positions unless approved by the lenders under the credit agreement;

any person or group that did not hold any equity interests in the general partner or the partnership on the date of the credit agreement acquires 20% or more of the equity interests in the partnership or the general partner;

the general partner ceases to be our sole general partner;

the partnership ceases to own 100% of the operating company; or

the operating company ceases to own 100% of the other borrowers.

The credit agreement contains financial covenants requiring us to maintain, on a rolling four-quarter basis:

a ratio of consolidated cash flow, as defined in the credit agreement, to consolidated interest expense of not less than 3.5 to 1.0 for the four most recent quarters;

a ratio of total funded debt on the last day of each quarter to consolidated cash flow of not more than 3.5 to 1.0 for the four most recent quarters (except as described below); and

consolidated cash flow of at least \$21.0 million. Our minimum consolidated cash flow will be increased by 80% of any consolidated cash flow acquired in an acquisition.

The credit agreement was amended in November 2004 to amend the leverage ratio from 3.5 to 1 to 3.75 to 1 until September 30, 2005 at which time it reverted back to 3.5 to 1. As of March 31, 2007, the Company was in compliance with all debt covenants.

For purposes of determining our compliance with the covenants described above, total funded debt includes all indebtedness for borrowed money (except that if we reduce borrowings under our revolving credit facility that are designated for the purpose of funding a regularly scheduled quarterly distribution to unitholders to not more than \$5.0 million for a period of at least 30 consecutive days at least once during each consecutive 12-month period prior to the maturity of the revolving credit facility, then the amount of outstanding revolving loans to be included in total funded debt will be an amount not to exceed \$5.0 million), purchase money indebtedness, obligations under letters of credit, capitalized leases, if any, and the deferred purchase price of any property or services. Consolidated cash flow is based on our adjusted EBITDA and is defined in the credit agreement as net income plus, among other things:

interest expense;

taxes;

depreciation and amortization;

non-cash cost of land and crypts;

extraordinary losses;

other non-cash items;

increase (decrease) in deferred cemetery revenues, net (excluding deferred margin);

increase (decrease) in accounts receivable;

increase (decrease) in merchandise liability; and

increase (decrease) in merchandise trust (excluding any change in trust income receivable).

Consolidated cash flow is adjusted to exclude, among other things, extraordinary gains, gains from sales of assets outside the ordinary course of business and non-cash items.

The credit agreement limits the ability of the partnership, our general partner, our operating company and any of our other subsidiaries, among other things, to:

enter into a new line of business;

enter into any agreement of merger or acquisition;

sell, transfer, assign or convey assets;

grant certain liens;

incur or guarantee additional indebtedness;

make certain loans, advances and investments;

declare and pay dividends and distributions;

enter into certain leases;

enter into transactions with affiliates; and

make voluntary payments or modifications of indebtedness.

*Senior Secured Notes.* Concurrent with the closing of our initial public offering, StoneMor Operating LLC and its existing subsidiaries issued and sold \$80.0 million in aggregate principal amount of senior secured notes. The net proceeds of the senior secured notes were used to repay a portion of our then existing indebtedness.

The senior secured notes rank pari passu with all of our other senior secured debt, including the revolving credit facility and the acquisition facility, subject to the description of the collateral securing the senior secured notes described below. The senior secured notes are guaranteed by the partnership, our general partner and any future subsidiaries of our operating company. Obligations under the senior secured notes are secured by a first priority lien and security interest covering substantially all of the assets of the issuers, whether then owned or thereafter acquired, other than specified receivable rights, excluding trust accounts and certain proceeds required by law to be placed in such trust accounts and funds held in trust accounts, our general partner's general partner interest in the Partnership and our general partner's incentive distribution rights under our partnership agreement, and a first priority lien and security interest covering those specified receivable rights, each as described above, of the issuers and the guarantors, whether then owned or thereafter acquired.

The senior secured notes mature on September 20, 2009 and bear interest at a rate of 7.66% per annum. Interest on the senior secured notes is payable quarterly, commencing on December 20, 2004. There will be no principal amortization prior to the final maturity of the senior secured notes.

The senior secured notes are redeemable, at our option, at any time in whole or in part at a make-whole premium. The make-whole premium is calculated on the basis of a discount rate equal to the yield on the U.S. treasury notes having a constant maturity comparable to the remaining term of the senior secured notes, plus 100 basis points. The senior secured notes are not subject to any sinking fund provisions.



The senior secured notes limit the ability of the partnership, our general partner, our operating company and any of our other subsidiaries, among other things, to:

enter into a new line of business;

enter into any agreement of merger or acquisition;

sell, transfer, assign or convey assets;

grant certain liens;

incur or guarantee additional indebtedness;

make certain loans, advances and investments;

declare and pay dividends and distributions;

enter into certain leases;

enter into transactions with affiliates; and

make voluntary payments or modifications of indebtedness.

The note purchase agreement also contains financial covenants requiring us to maintain, on a rolling four-quarter basis:

a ratio of consolidated cash flow, as defined in the note purchase agreement, to consolidated interest expense of not less than 3.5 to 1.0 for the four most recent quarters;

a ratio of total funded debt on the last day of each quarter to consolidated cash flow of not more than 3.5 to 1.0 for the four most recent quarters (except as described below); and

consolidated cash flow of at least \$21.0 million. Our minimum consolidated cash flow will be increased by 80% of any consolidated cash flow acquired in an acquisition.

The note purchase agreement was amended in November 2004 to amend the leverage ratio from 3.5 to 3.75 to 1 until September 30, 2005 at which time it reverted back to 3.5 to 1. As of March 31, 2007, the Company was in compliance with all debt covenants.

For purposes of determining our compliance with the covenants described above, total funded debt and consolidated cash flow are defined in the note purchase agreement in the same manner as they are defined in our new credit agreement.

Each of the following is an event of default under the note purchase agreement:

failure to pay any principal, interest, fees, expenses or other amounts when due;

failure of any of our representations and warranties to be materially correct;

failure to observe any covenant included in the note purchase agreement beyond specified cure periods in specified cases;

the occurrence of a default under other indebtedness of the partnership, our general partner, our operating company or any of our other subsidiaries;

the occurrence of specified bankruptcy or insolvency events involving the partnership, our operating company, our general partner or our other subsidiaries;

a change of control; or

the entry of judgments against the partnership, our general partner, our operating company or any of our other subsidiaries in excess of certain allowances.

Change of control is defined as the occurrence of any of the following events:

any two of our chairman, chief executive officer or chief financial officer on the closing date of the senior secured notes offering cease to hold such positions unless approved by the requisite noteholders;

any person or group that did not hold any equity interests in the general partner or the partnership on the closing date of the senior secured notes offering acquires 20% or more of the equity interests in the partnership or the general partner;

the general partner ceases to be our sole general partner;

the partnership ceases to own 100% of the operating company; or

the operating company ceases to own 100% of the other borrowers.

The initial offering of the senior secured notes was not registered under the Securities Act, and the senior secured notes may not be resold absent registration or an available exemption from the registration requirements of the Securities Act. The holders of the senior secured notes do not have registration rights. The senior secured notes are not listed or quoted on any national securities exchange or association.

*Intercreditor and Collateral Agency Agreement.* In connection with the closing of the credit facility and the private placement of the senior secured notes, our general partner, the partnership, our operating company, our other subsidiaries, the lenders under the new credit facility, the holders of the senior secured notes and Fleet National Bank, as collateral agent, entered into an intercreditor and collateral agency agreement setting forth the rights and obligations of the parties to the agreement as they relate to the collateral securing the new credit facility and the senior secured notes.

#### *Capital Expenditures*

The following table summarizes total maintenance capital expenditures and expansion capital expenditures, including for the construction of mausoleums and for acquisitions, for the periods presented (in thousands):

|                                   | Three Months Ended March 31, |                 |
|-----------------------------------|------------------------------|-----------------|
|                                   | 2006                         | 2007            |
| Maintenance capital expenditures  | \$ 922                       | \$ 1,170        |
| Expansion capital expenditures    | 878                          | 495             |
| <b>Total capital expenditures</b> | <b>\$ 1,800</b>              | <b>\$ 1,665</b> |

Pursuant to our partnership agreement, in connection with determining operating cash flows available for distribution, costs to construct mausoleum crypts and lawn crypts may be considered to be a combination of maintenance capital expenditures and expansion capital expenditures depending on the purposes for construction. Our general partner, with the concurrence of its conflicts committee, has the discretion to determine how to allocate a capital expenditure for the construction of a mausoleum crypt or a lawn crypt between maintenance capital expenditures and expansion capital expenditures. In addition, maintenance capital expenditures for the construction of a mausoleum crypt or a lawn crypt are not subtracted from operating surplus in the quarter incurred but rather are subtracted from operating surplus ratably during the estimated number of years it will take to sell all of the available spaces in the mausoleum or lawn crypt. Estimated life is determined by our general partner, with the concurrence of its conflicts committee.

*Seasonality.* The death care business is relatively stable and predictable. Although we experience seasonal increases in deaths due to extreme weather conditions and winter flu, these increases have not historically had any significant impact on our results of operations. In addition, we perform fewer initial openings and closings in the winter when the ground is frozen.

### **Item 3. Quantitative and Qualitative Disclosure About Market Risk**

The information presented below should be read in conjunction with the notes to our unaudited condensed consolidated financial statements included under Part I Item 1 Financial Statements in the Quarterly Report on Form 10-Q.

The market risk inherent in our market risk sensitive instruments and positions is the potential change arising from increases or decreases in interest rates and the prices of marketable equity securities, as discussed below. Our exposure to market risk includes forward-looking statements and represents an estimate of possible changes in fair value or future earnings that would occur assuming hypothetical future movements in interest rates or equity markets. Our views on market risk are not necessarily indicative of actual results that may occur and do not represent the maximum possible gains and losses that may occur, since actual gains and losses will differ from those estimated, based on actual fluctuations in interest rates, equity markets and the timing of transactions. We classify our market risk sensitive instruments and positions as other than trading.

*Interest-bearing Investments.* Our fixed-income securities subject to market risk consist primarily of investments in merchandise trusts and perpetual care trusts. As of March 31, 2007, fixed-income securities represented 33.7% of the funds held in merchandise trusts and 61.7% of the funds held in perpetual care trusts. The aggregate quoted market value of these fixed-income securities was \$53.7 million and \$106.6 million in merchandise trusts and perpetual care trusts, respectively, as of March 31, 2007. Each 1% change in interest rates on these fixed-income securities would result in changes of approximately \$0.5 million and \$1.1 million in the fair market values of the securities held in merchandise trusts and perpetual care trusts, respectively, based on discounted expected future cash flows. If these securities are held to maturity, no change in fair market value will be realized.



Our money market and other short-term investments subject to market risk consist primarily of investments held in merchandise trusts and perpetual care trusts. As of March 31, 2007, these investments accounted for approximately 9.4% and 6.3% of the funds held in merchandise trusts and perpetual care trusts, respectively. The fair market value of these investments was \$15.1 million and \$10.9 million in merchandise trusts and perpetual care trusts, respectively, as of March 31, 2007. Each 10% change in average interest rates applicable to these investments would result in changes of approximately \$1.5 million and \$1.1 million, respectively; in the aggregate fair market values of the perpetual care investments and the merchandise trust investments.

*Marketable Equity Securities.* Our marketable equity securities subject to market risk consist primarily of investments held in merchandise trusts and in the case of perpetual care trusts, investments in real estate investment trusts, or REITs. As of March 31, 2007, marketable equity securities represented 56.5% of funds held in merchandise trusts and 32.0% of funds held in perpetual care trusts. The aggregate fair market value of these marketable equity securities was \$90.4 million and \$55.2 million in merchandise trusts and perpetual care trusts, respectively, as of March 31, 2007, based on final quoted sales prices. Each 10% change in the average market prices of the equity securities would result in a change of approximately \$9.0 million and \$5.5 million in the fair market value of securities held in merchandise trusts and perpetual care trusts, respectively.

*Investment Strategies and Objectives.* Our internal investment strategies and objectives for funds held in merchandise trusts and perpetual care trusts are specified in an Investment Policy Statement which requires us to do the following:

State in a written document our expectations, objectives, tolerances for risk and guidelines in the investment of our assets;

Set forth a disciplined and consistent structure for managing all trust assets. This structure is based on a long-term asset allocation strategy, which is diversified across asset classes, investment styles and strategies. We believe this structure is likely to meet our stated objectives within our tolerances for risk and variability. This structure also includes ranges around the target allocations allowing for adjustments when appropriate to reduce risk or enhance returns. It further includes guidelines for the selection of investment managers and vehicles through which to implement the investment strategy;

Provide specific guidelines for each investment manager. These guidelines control the level of overall risk and liquidity assumed in their portfolio;

Appoint first-party investment advisors to oversee the specific investment managers and advise our Trust and Compliance Committee; and

Establish criteria to monitor, evaluate and compare the performance results achieved by the overall trust portfolios and by our investment managers. This allows us to compare the performance results of the trusts to our objectives and other benchmarks, including our peers, on a regular basis.

Our investment guidelines are based on relatively long investment horizons, which vary with the type of trust. Because of this, interim fluctuations should be viewed with appropriate perspective. The strategic asset allocation of the trust portfolios is also based on this longer-term perspective. However, in developing our investment policy, we have taken into account the potential negative impact on our operations and financial performance of significant short-term declines in market value.

We recognize the challenges we face in achieving our investment objectives in light of the uncertainties and complexities of contemporary investment markets. Furthermore, we recognize that, in order to achieve the stated long-term objectives, we may have short-term declines in market value. Given the need to maintain consistent values in the portfolio, we have attempted to develop a strategy which is likely to maximize returns and earnings without experiencing overall declines in value in excess of 3% over any 12-month period.

In order to consistently achieve the stated return objectives within our tolerance for risk, we use a strategy of allocating appropriate portions of our portfolio to a variety of asset classes with attractive risk and return characteristics, and low to moderate correlations of returns. See the notes to our unaudited condensed consolidated financial statements for a breakdown of the assets held in our merchandise trusts and perpetual care trusts by asset class.

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*Debt Instruments.* Our credit facility bears interest at a floating rate, based on LIBOR, which is adjusted quarterly. This credit facility will subject us to increases in interest expense resulting from movements in interest rates. As of March 31, 2007, we had

outstanding borrowings of \$9.4 million under our revolving credit line. As of March 31, 2007, we had \$15.3 million outstanding under our acquisition line of credit from which we borrowed \$5.25 million for the acquisition of 22 cemeteries and 6 funeral homes from Service Corporation International in November 2005 and \$9.0 million for the acquisition of 21 cemeteries and 14 funeral homes from Service Corporation International, joined by certain of its affiliated entities, in September 2006.

**Item 4. Controls and Procedures**  
**Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's Disclosure Committee and management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b). Based upon, and as of the date of this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective to provide reasonable assurance that information the Company is required to disclose in its reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

To remediate the material weakness disclosed in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006, related to the recognition of revenue from pre-need burial vaults, the Company has made changes to its automated revenue recognition systems which capture revenue recognition events that were previously excluded.

The Company's management believes that the procedures described above have remediated the material weaknesses identified.

Except as described above, there have been no changes in the Company's internal control over financial reporting that occurred during the Company's fiscal quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

**Part II Other Information**

**Item 1. Legal Proceedings**

We and certain of our subsidiaries may from time to time be parties to legal proceedings that have arisen in the ordinary course of business. While the outcome of these proceedings cannot be predicted with certainty, management does not expect these matters to have a material adverse effect on our consolidated financial position, results of operations or cash flows.

We carry insurance that we believe to be adequate. Although there can be no assurance that such insurance is sufficient to protect us against all contingencies, management believes that our insurance protection is reasonable in view of the nature and scope of our operations.

**Item 1A. Risk Factors**

In addition to the other information set forth in this quarterly report on Form 10-Q, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, which could materially affect our business, financial condition or future results. The risk factors in our Annual Report on Form 10-K have not materially changed. The risks described in our Annual Report on Form 10-K, are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of many factors, including the risks faced by us described in our Annual Report on Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

None.



**Item 6. Exhibits**

The following documents are filed as exhibits to this quarterly report on Form 10-Q.

| <b>Exhibit Number</b> | <b>Description</b>  |
|-----------------------|---|
| 3.1                   | Amendment No. 1 to First Amended and Restated Agreement of Limited Partnership of the Partnership dated February 27, 2007 (incorporated by reference to Exhibit 3.3 of Registrant's Current Report on Form 8-K filed on February 28, 2007).   |
| 10.1                  | Form of Indemnification Agreement by and between StoneMor GP LLC and Howard Carver, Peter Grunebaum, effective February 16, 2007 (incorporated by reference to Exhibit 10.9 of Registrant's Current Report on Form 8-K filed on September 30, 2004).  |
| 10.2                  | Third Amendment to Credit Agreement, dated May 7, 2007, by and among StoneMor GP LLC, StoneMor Partners L.P., StoneMor Operating LLC and its subsidiaries set forth on the signature page to the Third Amendment to the Credit Agreement, the Lenders party to the Third Amendment to the Credit Agreement and Bank of America, N.A., as Administrative Agent for the benefit of the Lenders, as Collateral Agent for the benefit of the Lenders and other Secured Creditors, as Swingline Lender and as Letter of Credit Issuer. |
| 31.1                  | Certification pursuant to Exchange Act Rule 13a-14(a) of Lawrence Miller, Chief Executive Officer, President and Chairman of the Board of Directors   |
| 31.2                  | Certification pursuant to Exchange Act Rule 13a-14(a) of William R. Shane, Executive Vice President and Chief Financial Officer   |
| 32.1                  | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350) and Exchange Act Rule 13a-14(b) of Lawrence Miller, Chief Executive Officer, President and Chairman of the Board of Directors (furnished herewith)   |
| 32.2                  | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350) and Exchange Act Rule 13a-14(b) of William R. Shane, Executive Vice President and Chief Financial Officer (furnished herewith)   |

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**STONEMOR PARTNERS L.P.**

By: StoneMor GP LLC  
its general partner

May 10, 2007

/s/ Lawrence Miller  
Lawrence Miller  
Chief Executive Officer, President and Chairman of the Board of  
Directors (Principal Executive Officer)

May 10, 2007

/s/ William R. Shane  
William R. Shane  
Executive Vice President and Chief Financial Officer (Principal  
Financial Officer)

Exhibit Index

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