STONEMOR PARTNERS LP
Form 10-Q
November 10, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2008

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

STONEMOR PARTNERS L.P.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**80-0103159** **(I.R.S. Employer** **Identification No.)**
311 Veterans Highway, suite B	
Levittown, Pennsylvania **(Address of principal executive offices)**	**19056** **(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)

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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer x	Non-accelerated filer ¨ (Do not check if smaller reporting company)	Smaller reporting company ¨

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

The number of the registrant s outstanding common units at November 10, 2008 was 9,681,319

Table of Contents

Index Form 10-Q

Table of Contents

Part I Financial Information

Item 1. Financial Statements

StoneMor Partners L.P.

Condensed Consolidated Balance Sheets

(in thousands)

(unaudited)

	December 31, 2007	September 30, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 13,800	$ 13,355
Accounts receivable, net of allowance	32,063	32,878
Prepaid expenses	2,707	3,843
Other current assets	5,193	4,154
Total current assets	53,763	54,230
Long-term accounts receivable - net of allowance	40,081	39,779
Cemetery property	187,552	218,070
Property and equipment, net of accumulated depreciation	53,929	48,467
Merchandise trusts, restricted, at fair value	228,615	190,989
Perpetual care trusts, restricted, at fair value	208,579	176,082
Deferred financing costs - net of accumulated amortization	3,317	2,648
Deferred selling and obtaining costs	35,836	40,497
Other assets	85	551
Total assets	$ 811,757	$ 771,313
Liabilities and partners capital		
Current liabilities		
Accounts payable and accrued liabilities	$ 19,075	$ 14,901
Accrued interest	677	838
Current portion, long-term debt	386	80,797
Total current liabilities	20,138	96,536
Other long-term liabilities		1,733
Long-term debt	145,778	75,940
Deferred cemetery revenues, net	220,942	218,417
Merchandise liability	79,574	79,252
Total liabilities	466,432	471,878
Commitments and contingencies		
Non-controlling interest in perpetual care trusts	208,579	176,082
Partners capital		
General partner	2,737	2,437
Limited partners:		

Common	118,598	109,681
Subordinated	15,411	11,235
Total partners capital	136,746	123,353
Total liabilities and partners capital	$ 811,757	$ 771,313

See Accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

StoneMor Partners L.P.

Condensed Consolidated Statement of Operations

(in thousands, except unit data)

(unaudited)

	Three months ended September 30, 2007	Three months ended September 30, 2008	Nine months ended September 30, 2007	Nine months ended September 30, 2008
Revenues:				
Cemetery				
Merchandise	$ 19,477	$ 24,101	$ 57,338	$ 69,206
Services	7,188	9,077	21,523	28,066
Investment and other	6,438	6,801	19,913	22,249
Funeral home				
Merchandise	1,110	2,179	3,442	6,766
Services	1,163	3,625	4,364	10,846
Total revenues	35,376	45,783	106,580	137,133
Costs and Expenses:				
Cost of goods sold (exclusive of depreciation shown separately below):				
Perpetual care	845	1,089	2,685	3,241
Merchandise	4,054	4,626	11,802	13,763
Cemetery expense	7,933	10,914	22,593	31,367
Selling expense	7,145	8,674	21,860	25,800
General and administrative expense	4,031	5,484	11,462	16,013
Corporate overhead (including $1,774 and $631 in unit-based compensation for the three months ended September 30, 2007 and 2008 and $4,113 and $1,889 for the nine months ended September 30, 2007 and 2008)	5,821	5,426	16,054	16,443
Depreciation and amortization	1,111	1,387	2,900	3,394
Funeral home expense				
Merchandise	344	842	1,198	2,705
Services	1,041	2,281	3,057	6,796
Other	556	1,470	1,833	4,497
Total cost and expenses	32,881	42,193	95,444	124,019
Operating profit	2,495	3,590	11,136	13,114
Expenses related to refinancing	157		157	
Interest expense	2,263	3,202	6,441	9,521
Income before income taxes	75	388	4,538	3,593
Income taxes				
State	106	67	384	479
Federal	(24)	(14)	149	89
Total income taxes	82	53	533	568
Net income (loss)	$ (7)	$ 335	$ 4,005	$ 3,025
General partner s interest in net income (loss) for the period	$ (0)	$ 8	$ 81	$ 61
Limited partners interest in net income (loss) for the period				

Common	$	(4)	$	239	$	2,083	$	2,164
Subordinated	$	(3)	$	88	$	1,840	$	800
Net income (loss) per limited partner unit (basic and diluted)	$	(.00)	$	.03	$	.43	$	.25
Weighted average number of limited partners units outstanding (basic and diluted)		9,036		11,801		9,036		11,795

See Accompanying Notes to the Condensed Consolidated Financial Statements.

2

Table of Contents

StoneMor Partners L.P.

Condensed Consolidated Statement of Partners Capital

(in thousands)

(unaudited)

	Partners Capital				
	Limited Partners			General	
	Common	Subordinated	Total	Partner	Total
Balance, December 31, 2007	$ 118,597	$ 15,412	$ 134,009	$ 2,737	$ 136,746
Proceeds from units issued in acquisition	500		500		500
General partner contribution				68	68
Issuance of executive management units	1,910		1,910		1,910
Net income	328	121	449	9	458
Cash distribution	(4,438)	(1,639)	(6,077)	(129)	(6,206)
Balance, March 31, 2008	116,897	13,894	130,791	2,685	133,476
Net income	1,597	590	2,187	45	2,232
Cash distribution	(4,440)	(1,638)	(6,078)	(129)	(6,207)
Balance, June 30, 2008	114,054	12,846	126,900	2,601	129,501
Net income	239	88	327	8	335
Cash distribution	(4,612)	(1,699)	(6,311)	(172)	(6,483)
Balance, September 30, 2008	$ 109,681	$ 11,235	$ 120,916	$ 2,437	$ 123,353

See Accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

StoneMor Partners L.P.

Condensed Consolidated Statement of Cash Flows

(in thousands)

(unaudited)

	Nine months ended September 30, 2007	Nine months ended September 30, 2008
Operating activities:		
Net income	$ 4,005	$ 3,025
Adjustments to reconcile net income to net cash provided by operating activity:		
Cost of lots sold	3,536	4,980
Depreciation and amortization	2,900	3,394
Unit-based compensation	4,113	1,889
Changes in assets and liabilities that provided (used) cash:		
Accounts receivable	(2,940)	(5,000)
Allowance for doubtful accounts	804	1,705
Merchandise trust fund	(138)	66
Prepaid expenses	(696)	542
Other current assets	(644)	(324)
Other assets	(140)	(723)
Accounts payable and accrued and other liabilities	(2,493)	(2,699)
Deferred selling and obtaining costs	(1,662)	(4,661)
Deferred cemetery revenue	10,465	18,700
Merchandise liability	(2,333)	(1,799)
Net cash provided by operating activities	14,777	19,095
Investing activities:		
Cost associated with potential acquisitions	(1,323)	(2,077)
Additions to cemetery property	(1,676)	(3,268)
Purchase of subsidiaries, net of common units issued	(2,501)	(2,226)
Additions to property and equipment	(1,223)	(3,713)
Net cash used in investing activities	(6,723)	(11,284)
Financing activities:		
Cash distribution	(13,972)	(18,896)
Additional borrowings on long-term debt	45,921	20,309
Repayments of long-term debt	(33,709)	(9,737)
Sale of partner units		68
Cost of financing activities	(2,980)	
Net cash used in financing activities	(4,740)	(8,256)
Net increase (decrease) in cash and cash equivalents	3,314	(445)
Cash and cash equivalents - Beginning of period	9,914	13,800
Cash and cash equivalents - End of period	$ 13,228	$ 13,355

Supplemental disclosure of cash flow information				
Cash paid during the period for interest	$	6,721	$	9,360
Cash paid during the period for income taxes	$	3,257	$	3,310
Non-cash investing and financing activities				
Issuance of limited partner units for cemetery acquisition	$		$	500

See Accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

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

Nature of Operations

StoneMor Partners L.P. (StoneMor , the Company or the Partnership) is a provider of funeral and cemetery products and services in the death care industry in the United States. Through its subsidiaries, StoneMor offers a complete range of funeral merchandise and services, along with cemetery property, merchandise and services, both at the time of need and on a pre-need basis. As of September 30, 2008, the Partnership owned and operated 230 cemeteries and 59 funeral homes in 27 states within the United States and Puerto Rico.

Basis of Presentation

The condensed consolidated financial statements included in this form 10-Q have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All interim financial data is unaudited. However, in the opinion of management, the interim financial data as of September 30, 2008 and for the three and nine months ended September 30, 2007 and 2008, respectively, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim period. The results of operations for interim periods are not necessarily indicative of the results of operations to be expected for a full year.

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 14 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 $5.1 million and $8.5 million for the three months ended September 30, 2007 and 2008, respectively, and $16.2 million and $21.3 million for the nine months ended September 30, 2007 and 2008, respectively.

Summary of Significant Accounting Policies

The significant accounting policies followed by the Company are summarized below:

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with a maturity of three months or less from the time they are acquired to be cash equivalents.

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 September 30, 2007 and 2008, depreciation expense was $0.7 million and $1.2 million, respectively. For the nine months ended September 30, 2007 and 2008, depreciation expense was $2.1 million and $2.7 million, respectively.

5

Table of Contents

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 $3.1 million and $3.8 million at December 31, 2007 and September 30, 2008, respectively.

Sales of Cemetery Merchandise and Services

The Company sells its merchandise and services on both a pre-need and at-need basis. Sales of at-need cemetery services and merchandise are recognized as revenue when the service is performed or merchandise is delivered.

Pre-need sales are usually made on an installment contract basis. Contracts are usually for a period not to exceed 60 months with payments of principal and interest required. For those contracts that do not bear a market rate of interest, the Company imputes such interest (at a rate of 9.75% during the year ended December 31, 2007 and 9.0% during the nine months ended September 30, 2008) in order to segregate the principal and interest component of the total contract value.

At the time of a pre-need sale, the Company records an account receivable in an amount equal to the total contract value less any cash deposit paid net of an estimated allowance for customer cancellations. The revenue from both the sales and interest component of the account receivable is deferred. Interest revenue is recognized utilizing the effective interest method as payments are received. Sales revenue is recognized in accordance with the rules discussed below.

The allowance for customer cancellations is established based on management s estimates of expected cancellations and historical experiences and is currently approximately 10% of total contract values. Future cancellation rates may differ from this current estimate. Management will continue to evaluate cancellation rates and will make changes to the estimate should the need arise. Actual cancellations did not vary significantly from the estimates of expected cancellations at December 31, 2007 and September 30, 2008 respectively.

Revenue recognition related to sales of pre-need cemetery merchandise and services is governed by 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). Per this guidance, revenue from the sale of burial lots and constructed mausoleum crypts are deferred until such time that 10% of the sales price has been collected, at which time it is fully earned; revenues from the sale of unconstructed mausoleums are recognized using the percentage-of-completion method of accounting with no revenue being recognized until such time that 10% of the sales price has been collected while revenues from merchandise and services are recognized once 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 services are performed.

In order to appropriately match revenue and expenses, the Company 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.

The Company records a merchandise liability equal to the estimated cost to provide services and purchase merchandise for all outstanding and unfulfilled pre-need contracts. The merchandise liability is established and recorded at the time of the sale but is not recognized as an expense until such time that the associated revenue for the underlying contract is also recognized. The merchandise liability is established based on actual costs incurred or an estimate of future costs, which may include a provision for inflation. The merchandise liability is reduced when services are performed or when payment for merchandise is made by the Company and title is transferred to the customer.

Pursuant to state law, a portion of the proceeds from pre-need sales of merchandise and services is put into trust (the merchandise trust) until such time that the Company meets the requirements for releasing trust principle, which is generally delivery of merchandise or performance of services. All investment earnings generated by the assets in the merchandise trusts (including realized gains and losses) are deferred until the associated merchandise is delivered or the services are performed. The fair value of the funds held in merchandise trusts at December 31, 2007 and September 30, 2008 was approximately $228.6 million and $191.0 million, respectively (see Note 5).

Sales of Funeral Home Services

Revenue from funeral home services is recognized as services are performed and merchandise is delivered.

Pursuant to state law, a portion of proceeds received from pre-need funeral service contracts is put into trust while amounts used to defray the initial administrative costs are not. All investment earnings generated by the assets in the trust (including realized gains and losses) are deferred until the associated merchandise is delivered or the services are performed. The balance of the amounts in these trusts is included within the merchandise trusts above.

Table of Contents

Perpetual Care Trusts

Pursuant to state law, a portion of the proceeds from the sale of cemetery property is required to be paid into perpetual care trusts. All principal must remain in this trust into perpetuity while interest and dividends may be released and used to defray cemetery maintenance costs, which are expensed as incurred. Earnings from the perpetual care trusts are recognized in current cemetery revenues. The fair value of funds held in perpetual care trusts at December 31, 2007 and September 30, 2008 was $208.6 million and $176.1 million, respectively (see Note 6).

Deferred Cemetery Revenues, Net

In addition to amounts deferred on new contracts, Deferred cemetery revenues, net, 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. 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.

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 flows 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. No impairment charges were recorded in either the three or nine months ended September 30, 2008.

Other-than-temporary Impairment of Trust Assets

The Company determines whether or not the assets in the merchandise and perpetual care trust have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its market value.

For assets held in the perpetual care trusts, any reduction in the cost basis due to an other-than-temporary impairment is offset with an equal and opposite reduction in the non-controlling interest in perpetual care trusts reflected on our balance sheet and has no impact in earnings.

For assets held in the merchandise trust, any reduction in the cost basis due to an other-than-temporary impairment is recorded in deferred revenue.

The trust footnotes (notes 5 and 6) disclose the adjusted cost basis of the assets in the trust. This adjusted cost basis includes any adjustments to the original cost basis due to other-than-temporary impairments.

The Company has determined that there were 11 securities in the merchandise trust, with an aggregate cost of approximately $2.1 million, an aggregate market value of approximately $0.9 million, and a resulting aggregate impairment in value of approximately $1.2 million, wherein such impairment is considered to be other-than-temporary at September 30, 2008. Accordingly, the Company has adjusted the cost basis of each of these assets to their current value and offset this change against deferred revenue. This reduction in deferred revenue will be reflected in earnings in future periods as the underlying merchandise is delivered or the underlying service is performed.

The Company has determined that there were 8 securities in the perpetual care trust, with an aggregate cost of approximately $1.9 million, an aggregate market value of approximately $0.6 million, and a resulting aggregate impairment in value of approximately $1.3 million, wherein such impairment is considered to be other-than-temporary at September 30, 2008. Accordingly, the Company has adjusted the cost basis of each of these assets to their current value and offset this change against non-controlling interest in perpetual care trusts. There is no impact on net income or partners capital due to this adjustment.

Net Income per Unit

Basic net income per unit is determined by dividing net income, after deducting the amount of net income allocated to the general partner interest from its issuance date of September 20, 2004, by the weighted average number of units outstanding during the period. Diluted net income per unit is calculated in the same manner as basic net income per unit, except that the weighted average number of outstanding units is increased to include the dilutive effect of outstanding unit options or phantom unit options.

Table of Contents

New Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, *Establishing the Fair Value Option for Financial Assets and Liabilities* (SFAS 159), to permit all entities to choose to elect to measure eligible financial instruments at fair value. SFAS 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 (* SFAS 157). The Company adopted this guidance effective January 1, 2008 and did not elect the fair value option for any of its eligible assets or liabilities as of this date.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R requires that acquirers in a business combination identify and record at fair value all of the assets and liabilities acquired as well as any non-controlling interest resulting from such business combination. Goodwill will be recognized when the fair value of consideration paid or transferred to the acquiree plus the fair value of any non-controlling interest exceeds the fair value of identified assets acquired less the fair value of liabilities assumed. A gain from a bargain purchase will be recognized when the fair value of consideration paid or transferred to the acquiree plus the fair value of any non-controlling interest is less than the fair value of identified assets acquired less the fair value of liabilities assumed. Gains from bargain purchases will be recognized in earnings in the period in which the acquisition occurs. SFAS 141R is effective as of the beginning of an entity s first fiscal year beginning after December 15, 2008. SFAS 141R cannot be applied retrospectively and is not applicable to any business combinations that occur before the adoption date. Accordingly, while SFAS 141R may impact the accounting treatment on certain business combinations the Company may enter into after the effective date, it does not have any impact on these financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statement* amendments of ARB No. 51 (SFAS 160). SFAS 160 states that accounting and reporting for minority interests will be recharacterized as non-controlling interests and classified as a component of equity. SFAS 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding non-controlling interest in one or more subsidiaries or that deconsolidate a subsidiary. This statement is effective as of the beginning of an entity s first fiscal year beginning after December 15, 2008. The Company is currently evaluating the impact the adoption of SFAS No. 160 will have on its consolidated financial statements.

In February 2008, the FASB Emerging Issues Task Force issued EITF Issue No. 07-04, *Application of the Two-Class Method under FASB Statement No. 128, Earnings per Share, to Master Limited Partnerships* (EITF 07-04). EITF 07-04 specifies when a master limited partnership that contains incentive distribution rights (IDR s) should classify said IDR s as a separate class of units for which a separate earnings per unit calculation should be made. EITF 07-04 is effective for fiscal years beginning after December 15, 2008. Early application is not permitted. The Company is currently evaluating the effect that the adoption of EITF 07-04 will have on the partnership s net earnings per unit.

Use of Estimates

Preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenue and expense during the reporting periods. As a result, actual results could differ from those estimates. The most significant estimates in the financial statements are the valuation of assets in the merchandise trust and perpetual care trust, allowance for cancellations, unit-based compensation, merchandise liability, deferred sales revenue, deferred margin, deferred merchandise trust investment earnings, deferred obtaining costs and income taxes. Deferred sales revenue, deferred margin and deferred merchandise trust investment earnings are included in deferred cemetery revenues, net, on the consolidated balance sheets.

Table of Contents

2. LONG-TERM ACCOUNTS RECEIVABLE, NET OF ALLOWANCE

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

	December 31, 2007	September 30, 2008
	(in thousands)	
Customer receivables	$ 94,733	$ 100,122
Unearned finance income	(11,049)	(12,509)
Allowance for contract cancellations	(11,540)	(14,956)
	72,144	72,657
Less: current portion - net of allowance	32,063	32,878
Long-term portion - net of allowance	$ 40,081	$ 39,779

Activity in the allowance for contract cancellations is as follows:

	December 31, 2007	September 30, 2008
	(in thousands)	
Balance - Beginning of period	$ 12,243	$ 11,540
Reserve on acquired contracts	115	1,710
Provision for cancellations	10,493	9,320
Charge-offs - net	(11,311)	(7,614)
Balance - End of period	$ 11,540	$ 14,956

3. CEMETERY PROPERTY

Cemetery property consists of the following:

	December 31, 2007	September 30, 2008
	(in thousands)	
Developed land	$ 22,676	$ 26,687
Undeveloped land	129,380	147,177
Mausoleum crypts and lawn crypts	35,496	44,206
Total	$ 187,552	$ 218,070

4. PROPERTY AND EQUIPMENT

Major classes of property and equipment follow:

	December 31, 2007	September 30, 2008
	(in thousands)	
Building and improvements	$ 42,215	$ 44,344
Furniture and equipment	33,184	27,927
	75,399	72,271
Less: accumulated depreciation	(21,470)	(23,804)
Property and equipment - net	$ 53,929	$ 48,467

Table of Contents

5. MERCHANDISE TRUSTS

The cost and market value associated with the assets held in merchandise trusts at December 31, 2007 and September 30, 2008 were as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market
		(in thousands)		
As of December 31, 2007				
Short-term investments	$ 23,071	$	$	$ 23,071
Fixed maturities:				
U.S. Government and federal agency	3,720	32	(21)	3,731
U.S. State and local government agency	2,178	29	(9)	2,198
Corporate debt securities	3,896	11	(133)	3,774
Other debt securities	89,827			89,827
Total fixed maturities	99,621	72	(163)	99,530
Mutual funds - debt securities	31,611	612	(1,410)	30,813
Mutual funds - equity securities	47,242	111	(6,658)	40,695
Equity securities	36,082	1,314	(2,889)	34,507
Total	$ 237,627	$ 2,109	$ (11,121)	$ 228,615

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market
		(in thousands)		
As of September 30, 2008				
Short-term investments	$ 20,784	$	$	$ 20,784
Fixed maturities:				
U.S. Government and federal agency	5,369	30	(50)	5,349
U.S. State and local government agency	5,916	37	(69)	5,884
Corporate debt securities	3,390		(390)	3,000
Other debt securities	10,237			10,237
Total fixed maturities	24,912	67	(509)	24,470
Mutual funds - debt securities	41,230		(5,664)	35,566
Mutual funds - equity securities	97,311		(23,817)	73,495
Equity securities	46,623	1,149	(11,097)	36,674
Total	$ 230,860	$ 1,216	$ (41,087)	$ 190,989

An aging of unrealized losses on the Company s investments in fixed maturities and equity securities at September 30, 2008 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)			
Fixed maturities:						
U.S. Government and federal agency	$ 2,419	$ 38	$ 377	$ 12	$ 2,796	$ 50
U.S. State and local government agency	3,340	59	182	10	3,522	69
Corporate debt securities	1,693	182	1,164	208	2,857	390
Other debt securities						
Total fixed maturities	7,452	279	1,723	230	9,175	509
Mutual funds - debt securities	22,648	1,307	12,917	4,357	35,565	5,664
Mutual funds - equity securities	34,411	10,114	39,084	13,703	73,495	23,817
Equity securities	16,197	4,017	17,467	7,080	33,664	11,097
Total	$ 80,708	$ 15,717	$ 71,191	$ 25,370	$ 151,899	$ 41,087

Table of Contents

The Company determines whether or not the assets in the merchandise trust have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its market value. Any reduction in the cost basis due to an other-than-temporary impairment is recorded in deferred revenue.

The Company has determined that there were 11 securities in the merchandise trust, with an aggregate cost of approximately $2.1 million, an aggregate market value of approximately $0.9 million, and a resulting aggregate impairment in value of approximately $1.2 million, wherein such impairment is considered to be other-than-temporary at September 30, 2008. Accordingly, the Company has adjusted the cost basis of each of these assets to their current value and offset this change against deferred revenue. This reduction in deferred revenue will be reflected in earnings in future periods as the underlying merchandise is delivered or the underlying service is performed.

A reconciliation of the Company s merchandise trust activities for the three and nine months ended September 30, 2008 is presented below:

Three months ended September 30, 2008

Market Value @ 6/30/2008	**Contributions**	**Distributions**	**Interest/ Dividends**	**Capital Gain Distributions**	**Realized Gain/ Loss**	**Taxes**	**Fees**	**Unrealized Change in Market Value**	**Change in Accrued Income**	**Market Value @ 9/30/2008**
				(in thousands)						
$206,639	$ 15,316	$ (13,008)	$ 2,821	$	$ (522)	$	$ (274)	$ (19,997)	$ 14	$ 190,989
$206,639	$ 15,316	$ (13,008)	$ 2,821	$	$ (522)	$	$ (274)	$ (19,997)	$ 14	$ 190,989

Nine months ended September 30, 2008

Market Value @ 12/31/2007	**Contributions**	**Distributions**	**Interest/ Dividends**	**Capital Gain Distributions**	**Realized Gain/ Loss**	**Taxes**	**Fees**	**Unrealized Change in Market Value**	**Change in Accrued Income**	**Market Value @ 9/30/2008**
				(in thousands)						
$228,615	$ 41,923	$ (53,694)	$ 7,746	$ 584	$ (1,195)	$ (1,311)	$ (794)	$ (30,860)	$ (25)	$ 190,989
$228,615	$ 41,923	$ (53,694)	$ 7,746	$ 584	$ (1,195)	$ (1,311)	$ (794)	$ (30,860)	$ (25)	$ 190,989

The Company deposited $7,535 and $15,316 and withdrew $10,220 and $13,008 from the trusts during the three month period ended September 30, 2007 and 2008, respectively. The Company deposited $33,454 and $41,923 and withdrew $37,502 and $53,694 from the trusts during the nine month period ended September 30, 2007 and 2008, respectively. During the three months ended September 30, 2007, purchases and sales of securities available for sale included in trust investments were $20,877 and $20,970, respectively. During the three months ended September 30, 2008, purchases and sales of securities available for sale included in trust investments were $31,343 and $23,694, respectively. During the nine months ended September 30, 2007, purchases and sales of securities available for sale included in trust investments were $103,721 and $138,479, respectively. During the nine months ended September 30, 2008, purchases and sales of securities available for sale included in trust investments were $258,518 and $184,983, respectively.

6. PERPETUAL CARE TRUSTS.

The cost and market value associated with the assets held in perpetual care trusts at December 31, 2007 and September 30, 2008 were as follows:

As of December 31, 2007	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market
		(in thousands)		
Short-term investments	$ 13,955	$	$	$ 13,955
Fixed maturities:				
U.S. Government and federal agency	7,625	78	(16)	7,687
U.S. State and local government agency	3,790	74	(8)	3,856
Corporate debt securities	15,314	73	(495)	14,892
Other debt securities	51,313			51,313
Total fixed maturities	78,042	225	(519)	77,748
Mutual funds - debt securities	46,795	68	(2,386)	44,477
Mutual funds - equity securities	50,166	263	(3,881)	46,548
Equity Securities	28,787	544	(3,480)	25,851
Total	$ 217,745	$ 1,100	$ (10,266)	$ 208,579

As of September 30, 2008	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market
		(in thousands)		
Short-term investments	$ 18,865	$	$	$ 18,865
Fixed maturities:				
U.S. Government and federal agency	9,359	61	(71)	9,349
U.S. State and local government agency	9,990	87	(98)	9,979
Corporate debt securities	13,351	2	(1,433)	11,920
Other debt securities	728			728
Total fixed maturities	33,428	150	(1,602)	31,976
Mutual funds - debt securities	56,518	17	(10,782)	45,753
Mutual funds - equity securities	72,483		(20,723)	51,760
Equity Securities	36,013	756	(9,041)	27,728
Total	$ 217,307	$ 923	$ (42,148)	$ 176,082

An aging of unrealized losses on the Company s investments in fixed maturities and equity securities at September 30, 2008 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)			
Fixed maturities:						
U.S. Government and federal agency	$ 4,008	$ 60	$ 432	$ 11	$ 4,440	$ 71
U.S. State and local government agency	4,946	89	275	9	5,221	98
Corporate debt securities	7,013	745	4,406	688	11,419	1,433
Other debt securities						

Total fixed maturities	15,967	894	5,113	708	21,080	1,602
Mutual funds - debt securities	19,839	1,925	24,014	8,857	43,853	10,782
Mutual funds - equity securities	21,704	9,826	30,056	10,897	51,760	20,723
Equity Securities	5,751	1,321	20,711	7,720	26,462	9,041
Total	$ 63,261	$ 13,966	$ 79,894	$ 28,182	$ 143,155	$ 42,148

The Company determines whether or not the assets in the perpetual care trust have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its market value. Any reduction in the cost basis due to an other-than-temporary impairment is offset with an equal an opposite reduction in the non-controlling interest in perpetual care trusts reflected on our balance sheet and has no impact in earnings. The Company has determined that there were 8 securities in the perpetual care trust, with an aggregate cost of approximately $1.9 million, an aggregate market value of approximately $0.6 million, and

Table of Contents

a resulting aggregate impairment in value of approximately $1.3 million, wherein such impairment is considered to be other-than-temporary at September 30, 2008. Accordingly, the Company has adjusted the cost basis of each of these assets to their current value and offset this change against non-controlling interest in perpetual care trusts. There is no impact on net income or partners capital due to this adjustment.

A reconciliation of the Company s perpetual care trust activities for the three and nine months ended September 30, 2008 is presented below:

Three months ended September 30, 2008

Market Value @ 6/30/2008	Contributions	Distributions	Interest/ Dividends	Capital Gain Distributions	Realized Gain/ Loss	Taxes	Fees	Unrealized Change in Market Value	Change in Accrued Income	Market Value @ 9/30/2008
				(in thousands)						
$198,723	$ 599	$ (4,015)	$ 3,747	$	$ (97)	$	$ (236)	$ (22,661)	$ 22	$ 176,082
$198,723	$ 599	$ (4,015)	$ 3,747	$	$ (97)	$	$ (236)	$ (22,661)	$ 22	$ 176,082

Nine months ended September 30, 2008

Market Value @ 12/31/2007	Contributions	Distributions	Interest/ Dividends	Capital Gain Distributions	Realized Gain/ Loss	Taxes	Fees	Unrealized Change in Market Value	Change in Accrued Income	Market Value @ 9/30/2008
				(in thousands)						
$208,579	$ 18,381	$ (26,945)	$ 10,190	$ 715	$ 1,921	$ (444)	$ (657)	$ 32,059	$ 243	$ 176,082
$208,579	$ 18,381	$ (26,945)	$ 10,190	$ 715	$ 1,921	$ (444)	$ (657)	$ 32,059	$ 243	$ 176,082

The Company deposited $8,239 and $599 and withdrew $7,689 and $4,015 from the trusts during the three months ended September 30, 2007 and 2008, respectively. The company deposited $15,605 and $18,381 and withdrew $20,390 and $26,945 from the trusts during the nine months ended September 30, 2007 and 2008, respectively. During the three months ended September 30, 2007, purchases and sales of securities available for sale included in trust investments were $56,269 and $52,880, respectively. During the three months ended September 30, 2008, purchases and sales of securities available for sale included in trust investments were $17,866 and $17,809, respectively. During the nine months ended September 30, 2007, purchases and sales of securities available for sale included in trust investments were $191,511 and $169,522, respectively. During the nine months ended September 30, 2008, purchases and sales of securities available for sale included in trust investments were $155,483 and $104,117, respectively.

Table of Contents

The Company recorded income from perpetual care trusts of $2.7 million and $7.4 million for the three and nine months ended September 30, 2007, respectively and $2.9 million and $9.7 million during the same period of 2008. This income is classified as cemetery revenues in the consolidated statements of operations.

7. LONG-TERM DEBT

The Company had the following outstanding debt at:

	December 31, 2007	September 30, 2008
	(in thousands)	
Insurance premium financing, due in installments (4.75%)	$ 350	$ 751
Vehicle Financing	61	83
Acquisition Credit Facility, due September 2012 (interest rate - Libor + 3.25%)	6,253	7,903
Revolving Credit Facility, due September 2012 (interest rate - Libor + 3.25%)	7,000	15,500
Series A senior secured notes, due 2009 (interest rate - 7.66%)	80,000	80,000
Series B senior secured notes, due 2012 (interest rate - 9.34%)	35,000	35,000
Series C senior secured notes, due 2012 (interest rate - 9.09%)	17,500	17,500
Total	146,164	156,737
Less current portion	386	80,797
Long-term portion	$ 145,778	$ 75,940

Acquisition Credit Facility and Revolving Credit Facility

On August 15, 2007, StoneMor Operating LLC (the Operating Company) and certain of its subsidiaries, (collectively, the Borrowers) entered into the Amended and Restated Credit Agreement (the Credit Agreement) with Bank of America, N.A. (Bank of America), other lenders, and Banc of America Securities LLC (collectively, the Lenders). Capitalized terms which are not defined in this Quarterly Report on Form 10-Q shall have the same meaning assigned to such terms in the Credit Agreement.

The Credit Agreement provides for both an acquisition credit facility (the Acquisition Credit Facility) and a revolving credit facility (the Revolving Credit Facility). Both of these facilities have a five-year term.

The maximum amount available under the Acquisition Credit Facility is currently $40 million. The Lenders have an uncommitted option of increasing this maximum amount by an additional $15 million. Any amount repaid by the Borrowers under the terms of and during the term of the Acquisition Credit Facility cannot be reborrowed.

The maximum amount available under the Revolving Credit Facility is currently $25 million. The Lenders have an uncommitted option of increasing this maximum amount by an additional $10 million. There is also a provision for certain Swing Line Loans, up to a maximum of $5 million provided solely by Bank of America. Any amount repaid by the Borrowers under the terms of and during the term of the Revolving Credit Facility can be reborrowed.

Loans outstanding under the Acquisition Credit Facility and the Revolving Credit Facility bear interest at a per annum rate based upon a base rate (the Base Rate) or a Eurodollar rate (the Eurodollar Rate) plus a margin ranging from 0% to .75% over the Base Rate and 2.25% to 3.25% over the Eurodollar rate, as selected by the Borrowers. The Base Rate is the higher of (a) the Federal Funds Rate plus 0.5% or (b) the prime rate as set by Bank of America. The Eurodollar Rate equals the British Bankers Association LIBOR Rate. Margin is determined by the ratio of consolidated funded debt to consolidated EBITDA of the Company.

The Credit Agreement requires the Borrowers to pay an unused commitment fee, which is calculated based on the amount by which the commitments under the Credit Agreement exceed the usage of such commitments. The Borrowers are also required to pay certain additional fees to Bank of America as Administrative Agent, and BAS as Arranger.

The proceeds of the Acquisition Credit Facility may be used by the Borrowers to finance (i) Permitted Acquisitions, as defined in the Credit Agreement, and (ii) the purchase and construction of mausoleums. The proceeds of the Revolving Credit Facility and Swing Line Loans may be utilized to finance working capital requirements, Capital Expenditures, as defined in the Credit Agreement, and for other general corporate purposes.

Borrowings under the Credit Agreement rank pari passu with all other senior secured debt of the Borrowers including the senior secured notes discussed below. The Borrowers obligations under the Credit Agreement are guaranteed by both the Company and StoneMor GP, LLC (StoneMor GP) (collectively, the Guarantors).

The Borrowers obligations under the Revolving Credit 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 second priority lien and security interest in substantially all assets other than those receivable rights of the Borrowers and Guarantors, excluding trust accounts and certain proceeds required by law to be placed into such trust accounts and funds held in trust accounts, StoneMor GP s general partner interest in the Company and StoneMor GP s incentive distribution rights under the Company s partnership agreement. The specified receivable rights include all accounts and other rights to payment arising under customer contracts or agreements 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.

The Borrowers obligations under the Acquisition Credit 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, StoneMor GP s general partner interest in the Company and StoneMor GP s incentive distribution rights under the Company s partnership agreement, and a secondary priority lien and security interest in those specified receivable rights. These assets secure the Acquisition Credit Facility and the senior secured notes described below. The priority of the liens and security interests securing the Acquisition Credit Facility ranks pari passu with the liens and security interests securing the senior secured notes described below.

The agreements governing the Revolving Credit Facility and the Acquisition Credit Facility contain restrictive covenants that, among other things, prohibit distributions upon defined events of default, restrict investments and sales of assets and require the Company to maintain certain financial covenants, including specified financial ratios. As of September 30, 2008, the Company was in compliance with all such covenants.

As of September 30, 2008, the Company had $23.4 million outstanding under the Credit Agreement.

Senior Secured Notes

On August 15, 2007, StoneMor GP, the Company, the Operating Company, and certain subsidiaries of the Operating Company (collectively, the Issuers) entered into the Amended and Restated Note Purchase Agreement (the Note Purchase Agreement) with Prudential Investment Management Inc., The Prudential Insurance Company of America, Prudential Retirement Insurance and Annuity Company, certain Affiliates of Prudential Investment Management Inc., iStar Financial Inc., SFT I, Inc., and certain Affiliates of iStar Financial Inc. (collectively, the Note Purchasers). Capitalized terms which are not defined in this Quarterly Report on Form 10-Q shall have the same meaning assigned to such terms in the Note Purchase Agreement.

Pursuant to the Note Purchase Agreement, the Issuers and the Note Purchasers agreed to (a) exchange certain senior secured notes previously issued by the Issuers to the Note Purchasers on September 20, 2004, for new Series A Notes, as defined in the Note Purchase Agreement, due September 20, 2009, in the amount of $80 million; and (b) issue Series B Notes, as defined in the Note Purchase Agreement, due August 15, 2012 in the aggregate amount of $35 million subject to the option, on an uncommitted basis, to issue/purchase additional secured Shelf Notes in the aggregate amount of up to $35 million, and to issue/purchase additional secured Shelf Notes to refinance the Series A Notes.

On December 21, 2007, pursuant to the Note Purchase Agreement, as amended, the Operating Company and its subsidiaries issued Senior Secured Series C Notes (the Series C Notes and together with Series A Notes, Series B Notes and the Shelf Notes are referred to as the Notes) in the aggregate principal amount of $17.5 million, due December 21, 2012.

The Series A Notes bear an interest rate of 7.66% per annum, the Series B Notes bear an interest of 9.34% per annum and the Series C Notes bear an interest rate of 9.09% per annum.

The Notes are guaranteed by the Company and StoneMor GP. The Notes rank pari passu with all other senior secured debt, including the Revolving Credit Facility and the Acquisition Credit Facility. Obligations under the 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 and a second priority lien and security interest covering those specified receivable rights of the Issuers, whether then owned or thereafter acquired.

These assets secure the Notes and the Acquisition Credit Facility described above. The priority of the liens and security interests securing the Notes ranks pari passu with the liens and security interests securing the Acquisition Credit Facility described above.

The Note Purchase Agreement contains restrictive covenants that, among other things, prohibit distributions upon defined events of default, restrict investments and sales of assets and require the Company to maintain certain financial covenants, including specified financial ratios. As of September 30, 2008, the Company was in compliance with all such covenants.

The Series A Notes mature and become due on September 20, 2009. The Company has no assurance if we will be able to repay or refinance them on terms as favorable as those that currently exist or at all, and any failure to repay or refinance the Series A Notes would trigger cross default provisions under other credit agreements. The Company is in the process of actively pursuing refinancing sources for the Series A Notes and expect to be able to refinance these notes. However, the credit market has tightened significantly in the past few months. This macroeconomic condition inherently increases the risk that the Company will be unable to refinance the Series A Notes on terms similar or more favorable than those of the existing Series A Notes or at all, which will have a material adverse effect on its financial condition, results of operations and liquidity. Although there can be no assurance, the Company expects final resolution during the second quarter of 2009.

Deferred financing costs were approximately $2.6 million at September 30, 2008, consisted of approximately $4.5 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 and their amendment during August 2007.

8. INCOME TAXES

As of December 31, 2007, the Company s taxable corporate subsidiaries had a federal net operating loss carryover of approximately $54.7 million, which will begin to expire in 2019 and $92.0 million in state net operating losses in which a portion 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 unit-holders, 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 nine months ended September 30, 2007 and 2008 respectively is based upon the estimated annual effective tax rates expected to be applicable to the Company for 2007 and 2008, respectively.

The Company adopted the provisions of FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. Previously, the Company had accounted for tax contingencies in accordance with Statement of Financial Accounting Standards 5, *Accounting for Contingencies*. As required by Interpretation 48, which clarifies Statement 109, *Accounting for Income Taxes* , the Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At the adoption date, the Company applied Interpretation 48 to all tax positions for which the statute of limitations remained open. The impact of adopting FIN 48 was not material as of the date of adoption or in subsequent periods. As a result of the implementation of Interpretation 48, the Company did not recognize any change in the liability for unrecognized tax benefits and there was no change to the January 1, 2007 balance of retained earnings. As of January 1, 2007, the Company had approximately $0.9 million of unrecognizable tax benefits. If recognized, the $0.9 million of the unrecognized tax benefits would reduce income tax expense and the Company s effective tax rate. There have been no material changes in unrecognized tax benefits since January 1, 2007.

Table of Contents

The Company and its subsidiaries are subject to US federal income tax as well as multiple state jurisdictions. The Company s effective tax rate fluctuates over time based on income tax rates in the various tax jurisdictions in which the Company operates and based on the level of earnings in those jurisdictions. Several entities of the Company are currently under examination by the Internal Revenue Service for its separate company US income tax returns for year ending December 31, 2005. The audits are only in the preliminary stages and management does not expect any material impact to the financials to occur as a result of these audits. The Company is not currently under examination by any state jurisdictions. The federal statute of limitations and certain states are open from 2004 forward. Management believes that the accrual for tax liabilities is adequate for all open years. This assessment relies on estimates and assumptions and may involve a series of complex judgments about future events. On the basis of present information, it is the opinion of the Company s management that there are no pending assessments that will result in a material adverse effect on the Company s condensed consolidated financial statements over the next twelve months.

The Company recognizes any interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses for all periods presented. The Company has not recorded any material interest or penalties during the current period.

9. DEFERRED CEMETERY REVENUES NET

At December 31, 2007 and September 30, 2008, deferred cemetery revenues, net, consisted of the following:

	December 31, 2007	September 30, 2008
	(in thousands)	
Deferred cemetery revenue	$ 160,429	$ 180,433
Deferred merchandise trust revenue	33,510	37,633
Deferred merchandise trust unrealized losses	(11,801)	(39,871)
Deferred pre-acquisition margin	62,428	66,562
Deferred cost of goods sold	(23,624)	(26,340)
Deferred cemetery revenues, net	$ 220,942	$ 218,417
Deferred selling and obtaining costs	$ 35,836	$ 40,497

Deferred selling and obtaining costs are carried as an asset on the condensed consolidated balance sheet in accordance with SFAS 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 September 30, 2008, 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 and $0.4 million for the three months ended September 30, 2007 and 2008, respectively, and $0.5 million and $1.3 million for the nine months ended September 30, 2007 and 2008, respectively.

Table of Contents

At September 30, 2008, operating leases will result in future payments in the following approximate amounts:

	(in thousands)
2008	$ 456
2009	1,624
2010	1,452
2011	1,300
2012	1,234
Thereafter	5,309
Total	$ 11,375

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 the Company prior to September 20, 2004. CFSI LLC has also agreed to indemnify the Company against additional income tax liabilities, if any, that arise from the consummation of the transactions related to the Company s formation in excess of those believed to result at the time of the closing of the Company s initial public offering. CFSI LLC has also agreed to indemnify the Company against the increase in income tax liabilities of its corporate subsidiaries resulting from any reduction or elimination of its 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 the Company, or from the Company s formation transactions in excess of such gain or income believed to result at September 20, 2004.

11. PARTNERS CAPITAL

Unit-Based Compensation

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards 123 R, *Share Based Payment* (SFAS 123 R). SFAS 123 R requires that company s record as an expense the fair value of share based payment awards made to their employees. Depending upon their form, the offset to the expense is either to equity (normally additional paid in capital) or is recorded as a liability.

The Company has issued to certain key employees and management unit-based compensation in the form of unit appreciation rights and phantom partnership units. Each of these awards qualifies as an equity award.

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

	Nine months ended September 30, 2007	Nine months ended September 30, 2008
	(in thousands)	
Unit appreciation rights	$ 128	$ 67
General partner equity grants	606	
Restricted phantom units	3,379	1,822
Total unit-based compensation expense	$ 4,113	$ 1,889

As of September 30, 2008, there was $0.1 million of unrecognized pretax compensation cost related to non-vested unit appreciation rights and $1.3 million of unrecognized pretax compensation cost related to non-vested restricted phantom units.

18

On January 9, 2008, 90,125 phantom units, issued to certain members of management, vested and common units representing limited partner interests were issued on a one-for-one basis. Based on the compensation expense previously recognized for these units, common unit-holder equity increased by $1,912.

12. ACQUISITIONS

The Company made two acquisitions during the nine months ended September 30, 2008. The first acquisition took place during the first quarter of the year and consisted of a single cemetery (the First Quarter Acquisition). The second acquisition took place in the third quarter of the year and consisted of six cemeteries and two funeral homes (the Third Quarter Acquisition).

The results of the operations of the acquired properties have been included in the condensed consolidated financial statements since the date of acquisition and are not material to the results of operations.

The Company paid $600,000 in cash and $500,000 in common units representing limited partnership interests to the sellers for the First Quarter Acquisition. Including the acquisition transaction costs, the transaction was valued at $1.2 million for accounting purposes.

The Company paid approximately $800,000 in cash to the sellers for the Third Quarter Acquisition. Including the acquisition transaction costs, the transaction was valued at $1.3 million for accounting purposes.

The following table summarizes the estimated fair values (in thousands) of the assets acquired and liabilities assumed as of the acquisition date for both the First Quarter Acquisition and the Third Quarter Acquisition.

Assets acquired	
Accounts receivable, net	$ 827
Cemetery property	6,744
Property and equipment	1,062
Merchandise trust funds, restricted at fair value	1,246
Total assets acquired	9,879
Liabilities assumed	
Deferred margin	3,839
Merchandise liability	3,543
Total liabilities assumed	7,382
Net assets acquired	$ 2,497

On December 21, 2007 the Company acquired 45 cemeteries and 30 funeral homes from Service Corporation International (NYSE: SCI) joined by certain of its direct and indirect subsidiary entities (the SCI Acquisition). The results of operations of these acquired cemeteries and funeral homes have been included in the condensed consolidated financial statements since that date.

The Company s balance sheets at December 31, 2007 and March 31, 2008 reflect purchase price allocations related to the SCI Acquisition that had not as of yet been finalized. These purchase price allocations were re-estimated in the third quarter of 2008 and resulted in an increase of the value of net assets acquired from $76.4 million to $78.1 million along with a reallocation of the various components of such net assets acquired.

Table of Contents

The following table reconciles amounts originally recorded and included in partners capital at December 31, 2007 and March 31, 2008 to amounts included in partners capital at September 30, 2008.

	Original	Re-estimate (In thousands)	Change
Assets			
Accounts receivable, net	$ 9,583	$ 6,038	$ (3,545)
Inventory	817		(817)
Cemetery property	15,861	42,184	26,323
Property and equipment	24,873	16,300	(8,573)
Merchandise trust assets	68,013	73,868	5,855
Total assets	119,147	138,390	19,243
Liabilities			
Deferred margin	22,222	25,303	3,081
Deferred interest	32		(32)
Merchandise liability	20,513	34,979	14,466
Total liabilities	42,767	60,282	17,515
Net assets	$ 76,380	$ 78,108	$ 1,728

13. SEGMENT INFORMATION

In conjunction with its September 2006 acquisition of 21 cemeteries and 14 funeral homes from Service Corporation International and as part of ongoing strategic planning and ongoing marketing studies of its potential customers, in the third quarter of 2007 the Company reorganized and disaggregated its single reportable segment into five distinct reportable segments which are classified as Cemetery Operations Southeast, Cemetery Operations Northeast, Cemetery Operations West, Funeral Homes, and Corporate.

The Company has chosen this level of reorganization and disaggregation of reportable segments due to the fact that a) each reportable segment has unique characteristics that set it apart from other segments; b) the Company has organized its management personnel at these operational levels; c) and it is the level at which its chief decision makers and other senior management evaluate performance.

The Company s Funeral Homes segment offers a range of funeral-related services such as family consultation, the removal of and preparation of remains and the use of funeral home facilities for visitation. These services are distinctly different than the cemetery merchandise and services sold and provided by the cemetery operations segments.

The cemetery operations segments sell interment rights, caskets, burial vaults, cremation niches, markers and other cemetery related merchandise. The nature of the Company s customers differs in each of our regionally based cemetery operating segments. Cremation rates in the West region are substantially higher (65% in Washington and Oregon) than they are in the Southeast region (12% in Alabama and Kentucky). Rates in the Northeast region tend to be somewhere between the two. Statistics indicate that customers who select cremation services have certain attributes that differ from customers who select other methods of interment. The disaggregation of cemetery operations into the three distinct regional segments is primarily due to these differences in customer attributes along with the previously mentioned management structure and senior management analysis methodologies.

The Company s Corporate segment includes various home office selling and administrative expenses that are not allocable to the other operating segments.

Table of Contents

Segment information as of and for the three and nine months ended September 30, 2007 and September 30, 2008 is as follows:

As of and for the three months ended September 30, 2007

	Cemeteries			Funeral			
	Southeast	Northeast	West	Homes (in thousands)	Corporate	Adjustment	Total
Revenues							
Sales	$ 12,836	$ 8,375	$ 2,333	$	$	$ (1,457)	$ 22,087
Service and other	5,631	5,795	908			(1,318)	11,016
Funeral home				2,273			2,273
Total revenues	18,467	14,170	3,241	2,273		(2,775)	35,376
Costs and expenses							
Cost of sales	2,912	1,902	465			(380)	4,899
Selling	3,939	2,527	732		188	(242)	7,144
Cemetery	3,500	3,534	899				7,933
General and administrative	2,083	1,498	451		(1)		4,031
Funeral home				1,941			1,941
Corporate					5,978		5,978
Total costs and expenses	12,434	9,461	2,547	1,941	6,165	(622)	31,926
Operating earnings	6,033	4,709	694	332	(6,165)	(2,153)	3,450
Interest expense	1,126	905	93	139			2,263
Depreciation and amortization	315	224	13	106	453		1,112
Earnings (losses) before taxes	$ 4,592	$ 3,580	$ 588	$ 87	$ (6,618)	$ (2,153)	$ 75
Supplemental information							
Total assets	$ 277,031	$ 280,207	$ 47,382	$ 15,733	$ 16,880	$	$ 637,233
Amortization of cemetery property	$ 685	$ 542	$ 33	$	$	$ (6)	$ 1,254
Long lived asset additions	$ 2,830	$ 39	$ 1,397	$ 24	$ 91	$	$ 4,381

As of and for the three months ended September 30, 2008

	Cemeteries			Funeral			
	Southeast	Northeast	West	Homes (in thousands)	Corporate	Adjustment	Total
Revenues							
Sales	$ 16,595	$ 8,764	$ 6,544	$	$	$ (4,987)	$ 26,915
Service and other	5,331	4,341	2,971			421	13,064
Funeral home				5,804			5,804
Total revenues	21,926	13,105	9,515	5,804		(4,566)	45,783

Costs and expenses							
Cost of sales	3,561	1,800	1,179			(824)	5,716
Selling	5,058	2,747	1,877		295	(1,303)	8,674
Cemetery	4,616	3,489	2,796		13		10,914
General and administrative	2,715	1,563	1,182		24		5,484
Funeral home				4,592			4,592
Corporate					5,426		5,426
Total costs and expenses	15,950	9,599	7,034	4,592	5,758	(2,127)	40,806
Operating earnings	5,976	3,506	2,481	1,212	(5,758)	(2,439)	4,978
Interest expense	1,298	619	713	572			3,202
Depreciation and amortization	392	237	124	280	354		1,387
Earnings (losses) before taxes	$ 4,286	$ 2,650	$ 1,644	$ 360	$ (6,112)	$ (2,439)	$ 388
Supplemental information							
Total assets	$ 329,607	$ 246,441	$ 144,715	$ 35,272	$ 15,278	$	$ 771,313
Amortization of cemetery property	$ 748	$ 361	$ 119	$	$	$ 368	$ 1,596
Long lived asset additions	$ 3,994	$ 199	$ (1,875)	$ 335	$ 130	$	$ 2,783

Table of Contents

As of and for the nine months ended September 30, 2007

	Cemeteries Southeast	Northeast	West	Funeral Homes	Corporate	Adjustment	Total
	(in thousands)						
Revenues							
Sales	$ 39,179	$ 25,983	$ 6,269	$	$	$ (6,973)	$ 64,458
Service and other	16,055	20,123	2,900			(4,762)	34,316
Funeral home				7,806			7,806
Total revenues	55,234	46,106	9,169	7,806		(11,735)	106,580
Costs and expenses							
Cost of sales	8,423	5,916	1,357			(1,209)	14,487
Selling	12,306	8,244	2,015		865	(1,571)	21,859
Cemetery	9,983	10,191	2,419				22,593
General and administrative	5,838	4,371	1,233		20		11,462
Funeral home				6,088			6,088
Corporate					16,211		16,211
Total costs and expenses	36,550	28,722	7,024	6,088	17,096	(2,780)	92,700
Operating earnings	18,684	17,384	2,145	1,718	(17,096)	(8,955)	13,880
Interest expense	3,180	2,553	284	424			6,441
Depreciation and amortization	943	700	29	283	946		2,901
Earnings (losses) before taxes	$ 14,561	$ 14,131	$ 1,832	$ 1,011	$ (18,042)	$ (8,955)	$ 4,538
Supplemental information							
Total assets	$ 277,031	$ 280,207	$ 47,382	$ 15,733	$ 16,880	$	$ 637,233
Amortization of cemetery property	$ 2,165	$ 1,849	$ 80	$	$	$ 180	$ 4,274
Long lived asset additions	$ 3,451	$ 147	$ 1,512	$ 141	$ 349	$	$ 5,600

As of and for the nine months ended September 30, 2008

	Cemeteries Southeast	Northeast	West	Funeral Homes	Corporate	Adjustment	Total
	(in thousands)						
Revenues							
Sales	$ 48,862	$ 25,490	$ 20,602	$	$	$ (17,586)	$ 77,368
Service and other	18,262	15,864	10,630			(2,603)	