

STONEMOR PARTNERS LP
Form 10-K/A
December 13, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED December 31, 2006

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.) |
| 155 Rittenhouse Circle | |
| Bristol, Pennsylvania (Address of principal executive offices) | 19007 (Zip Code) |
| Registrant's telephone number, including area code (215) 826-2800 | |

Securities registered pursuant to Section 12(b) of the Act: **Common Units**

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 aggregate market value of the common units held by non-affiliates of the registrant was approximately \$93.0 million as of June 30, 2006 based on \$19.40 per unit, the closing price of the common units as reported on the NASDAQ on that date.¹

Documents incorporated by reference: None

The number of the registrant's outstanding common units at March 15, 2007 was 4,795,780.

¹ The aggregate market value of the common units set forth above equals the number of the registrant's common units outstanding, reduced by the number of common units held by executive officers, directors and persons owning 10% or more of the registrant's common units, multiplied by the last reported sale price for the registrant's common units on June 30, 2006, the last day of the registrant's most recently completed second fiscal quarter. The information provided shall in no way be construed as an admission that any person whose holdings are excluded from this figure is an affiliate of the registrant or that any person whose holdings are included in this figure is not an affiliate of the registrant and any such admission is hereby disclaimed. The information provided herein is included solely for record keeping purposes of the Securities and Exchange Commission.

Table of Contents**Explanatory Note**

We are filing this Amendment No. 2 on Form 10-K/A (Amended 10-K) to our annual report on Form 10-K/A for the year ended December 31, 2006, initially filed with the Securities and Exchange Commission (SEC) on March 19, 2007 and subsequently amended on April 30, 2007 (Original 10-K), along with amendments to our quarterly reports on Form 10-Q for the quarterly periods ended March 31, 2007, June 30, 2007 and September 30, 2007 (such Forms 10-Q as amended, together with this Amended 10-K, the Amended Reports), to correct immaterial errors recently discovered in these previously filed reports.

With respect to the Amended 10-K, we are making immaterial corrections to the following information in Item 1., Business, of Part I and Item 6., Selected Financial Data, and Item 7., Management's Discussion and Analysis of Financial Condition and Results of Operations, as applicable, of Part II of the Original 10-K:

| Description of Corrected Item | Previously Reported Number | Corrected Number |
|--|---|---|
| The number of funeral homes purchased since 1999 | 19 | 21 |
| Approximate consolidated federal net operating loss carryover as of December 31, 2006 | \$35.4 million | \$40.9 million |
| Approximate state net operating losses as of December 31, 2006 | \$46.0 million | \$74.2 million |
| Increase in cemetery labor, as a component in the description of the change in cemetery expense, during the year ended December 31, 2005 as compared to the year ended December 31, 2004 | \$0.6 million | \$0.2 million |
| Expansion capital expenditures (in thousands) | \$18,851 for the year ended December 31, 2005 compared to \$20,313 for the year ended December 31, 2006 | \$18,994 for the year ended December 31, 2005 compared to \$20,532 for the year ended December 31, 2006 |
| A conforming change is being made in Item 6., Selected Financial Data, of Part II of the Original 10-K. | | |
| Total capital expenditures (in thousands) | \$21,043 for the year ended December 31, 2005 compared to \$22,372 for the year ended December 31, 2006 | \$21,186 for the year ended December 31, 2005 compared to \$22,591 for the year ended December 31, 2006 |

We believe that the corrections made in the Amended Reports, including those corrections described above, are not, individually or in the aggregate, material to our business, financial condition or results of operations. Accordingly, we believe that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) are effective to provide reasonable assurance that information we are required to disclose in our 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 our management as appropriate to allow timely decisions regarding required disclosure. Nonetheless, in light of the foregoing, we are reviewing our disclosure controls and procedures and intend to implement additional controls and procedures that we believe will enhance the effectiveness of our disclosure controls and procedures, including hiring an outside consultant to assist in the preparation of our annual report on Form 10-K for the year ending December 31, 2007 as well as hiring additional employees to assist with the preparation of our financial statements and SEC reports.

We are also correcting the number of outstanding common units at March 15, 2007 to 4,795,780 from 4,795,750 as reported on the cover page of the Original 10-K.

In addition, pursuant to the rules of the SEC, Item 15 of Part IV of the Original 10-K has been amended to contain currently dated certifications from our Chief Executive Officer and Chief Financial Officer, as required by Rule 13a-14(a) under the Securities Exchange Act of 1934, which certifications are filed herewith as Exhibits 31.1 and 31.2, respectively.

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This Amended 10-K only amends and restates the number of outstanding units on the cover page, Item 1 of Part I, Items 6 and 7 of Part II and Item 15 of Part IV of the Original 10-K to the extent described above, and no other information in the Original 10-K is amended hereby. None of the items restated herein nor any other item in the Original 10-K has been updated to reflect events, results or developments concerning our business, financial condition or results of operations occurring after the Original 10-K or to modify or update those disclosures affected by subsequent events. Except for the foregoing amended items, this Amended 10-K continues to describe conditions as of the date of the Original 10-K. Among other things, and without limiting the foregoing, forward looking statements made in the Original 10-K have not been revised to reflect events, results or developments that occurred or facts that became known to us after the date of the Original 10-K, and such forward looking statements should be read in their historical context.

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FORM 10-K OF STONEMOR PARTNERS, L.P.

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Item 1. Business

We were formed as a Delaware limited partnership to own and operate the assets and businesses previously owned and operated by Cornerstone Family Services, Inc., or Cornerstone, which was converted into CSFI LLC, a limited liability company, prior to our initial public offering of common units representing limited partner interests on September 20, 2004. 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. We, us, our, or similar terms, when used in a historical context, refer to Cornerstone Family Services, Inc. (and, after its conversion, CFSI LLC) and its subsidiaries and thereafter refer to StoneMor Partners L.P. and its subsidiaries.

We are the fourth-largest owner and operator of cemeteries in the United States. As of December 31, 2006, we operated 177 cemeteries in 21 states, located primarily in the eastern United States. We own 170 of these cemeteries, and we operate the remaining 7 under long-term management agreements with the cemetery associations that own the cemeteries. The cemetery products and services that we sell are:

| Interment Rights | Merchandise | Services |
|-------------------------|--------------------------------------|--|
| burial lots | burial vaults | installation of burial vaults |
| lawn crypts | caskets | installation of caskets |
| mausoleum crypts | grave markers and grave marker bases | |
| cremation niches | memorials | |
| perpetual care rights | | installation of other cemetery merchandise |

We sell these products and services both at the time of death, which we refer to as at-need, and prior to the time of death, which we refer to as pre-need. Whenever possible, we sell burial lots with pre-installed vaults. Our sales of real property, including burial lots (with and without installed vaults), lawn and mausoleum crypts and cremation niches, generate qualifying income sufficient for us to be treated as a partnership for federal income tax purposes. In 2006, we performed more than 26,000 burials and sold more than 21,100 interment rights (net of cancellations). Based on our sales of interment spaces in 2006, our cemeteries have a weighted average sales life of 236 years.

Our cemetery properties are located in Pennsylvania, West Virginia, Virginia, North Carolina, Maryland, New Jersey, Tennessee, Ohio, Rhode Island, Alabama, Connecticut, Delaware, Illinois, Kentucky, Oregon, Washington, Kansas, Michigan, Colorado, Missouri and Georgia. In 2006, our cemetery operations accounted for approximately 94.7% of our revenues.

We also own and operate 27 funeral homes in Alabama, Maryland, Ohio, Pennsylvania, West Virginia, Oregon, Kansas, Washington and Virginia. Eight of our 27 funeral homes are located on the grounds of cemeteries that we own. In 2006, more than 1,330 funerals were performed at our funeral homes, and our funeral home revenues accounted for approximately 5.3% of our revenues.

Operations

Cemetery Operations. Our cemetery operations include sales of cemetery interment rights, merchandise and services and the performance of cemetery maintenance and other services. An interment right entitles a customer to burial space in one of our cemeteries and the perpetual care of that burial space. Burial spaces, or lots, are parcels of property that hold interred human remains. Our cemeteries require a burial vault be placed in each burial lot. A burial vault is a rectangular container, usually made of concrete but also made of steel or plastic, which sits in the burial lot and in which the casket is placed. The top of the burial vault is buried approximately 18 to 24 inches below the surface of the ground, and the casket is placed inside the vault. Burial vaults prevent ground settling that otherwise occurs when a casket placed directly in the ground begins to decay creating uneven ground surface. Ground settling typically results in higher maintenance costs and increased potential liability for slip-and-fall accidents on the property. Lawn crypts are a series of closely spaced burial lots

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with preinstalled vaults and other improvements, such as landscaping, sprinkler systems and drainage. A mausoleum crypt is an above-ground structure that may be designed for a particular customer, which we refer to as a private mausoleum; or it may be a larger building that serves multiple customers, which we refer to as a community mausoleum. Cremation niches are spaces in which the ashes remaining after cremation, sometimes referred to as cremains, are stored. Cremation niches are often part of community mausoleums, although we sell a variety of cremation niches to accommodate our customers' preferences.

Grave markers, monuments and memorials are above-ground products that serve as memorials by showing who is remembered, the dates of birth and death and other pertinent information. These markers, monuments and memorials include simple plates, such as those used in a community mausoleum or cremation niche, flush-to-the-ground granite or bronze markers, headstones or large stone obelisks.

One of the principal services we provide at our cemeteries is an opening and closing, which is the digging and refilling of burial spaces to install the vault and place the casket into the vault. With pre-need sales, there are usually two openings and closings. During the initial opening and closing, we install the burial vault in the burial space. We usually perform this service shortly after the customer signs a pre-need contract. Advance installation allows us to withdraw the related funds from our merchandise trusts, making the amount in excess of our cost to purchase and install the vault available to us for other uses, and eliminates future merchandise trusting requirements for the burial vault and its installation. During the final opening and closing, we remove the dirt above the vault, open the lid of the vault, place the casket into the vault, close the vault lid and replace the ground cover. With at-need sales, we typically perform the initial opening and closing at the time we perform the final opening and closing. Our other services include the installation of other cemetery merchandise and the perpetual care related to interment rights.

The cost of a traditional interment at one of our cemeteries, together with all related services and merchandise, ranges from approximately \$1,600 to approximately \$6,000, and averages approximately \$2,800.

Managed Cemeteries. We operate 7 cemeteries in New Jersey, Connecticut and Ohio under management agreements with the 7 cemetery associations that own the cemetery properties. These cemetery associations are organized as nonprofit corporations either because state law requires cemetery properties to be owned by nonprofit entities, such as in New Jersey and Connecticut, or because they were originally established as nonprofit entities. We have voting control of four of these cemetery associations as a result of owning all of their outstanding stock, certificates of indebtedness or membership certificates. Three cemetery associations are owned by their lotholders or have no voting members. Because nonprofit entities in most states are restricted in their ability to distribute income, these 7 cemetery associations have entered into management agreements with us. The management agreements under which we operate these 7 cemeteries generally have terms ranging from 3 to 10 years and provide us with management fees that approximate what we would earn if we owned those cemeteries and held them in for-profit entities. In some of the states where we operate cemeteries under management agreements, we are entitled to significant termination fees if the agreements are terminated without our consent.

Funeral Home Operations. We own and operate 27 funeral homes, eight of which are located on cemetery properties that we own, in Alabama, Maryland, Ohio, Pennsylvania and Virginia. Since 1999, we have built two funeral homes and purchased 21. Our funeral homes offer a range of services to meet a family's funeral needs, including family consultation, the removal and preparation of remains, provision of caskets and related funeral merchandise, the use of funeral home facilities for visitation, worship and funeral services and transportation services. The cost of using the services of one of our funeral homes, including the purchase of a casket, ranges from approximately \$2,745 to approximately \$6,100 and averages approximately \$3,400. Funeral home operations primarily generate revenues from at-need sales, for which there is a smaller potential customer base than pre-need sales, and have low barriers to entry by competitors. By focusing primarily on cemeteries and deriving significant revenues from pre-need sales, we minimize our exposure to these types of challenges.

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We purchase caskets from Thacker Caskets, Inc. under a supply agreement that expires on December 31, 2015. This agreement entitles us to specified discounts on the price of caskets but requires that we purchase all of our caskets from Thacker Caskets, Inc. We do not have minimum purchase requirements under this supply agreement.

Cremation Products and Services. We operate three crematories on three of our cemeteries, but our primary cremation operations are sales of receptacles for cremains, such as urns, and the inurnment of cremains in niches or scattering gardens. While cremation products and services usually cost less than traditional burial products and services, they yield higher margins on a percentage basis and take up less space than burials. We sell cremation products and services on both a pre-need and at-need basis.

Pet Cemeteries. At many of our cemeteries, we maintain a separate piece of land that is used exclusively for the burial of pets. Our sales of pet cemetery products and services are similar to those for humans: we sell interment rights, burial vaults, caskets, cremation products and memorials. The costs of these products and services vary based on the size of the animal and the quality of the products. In 2006, sales of pet cemetery products and services totaled approximately \$166,000.

Sales Contracts

Pre-need products and services are typically sold on an installment basis. At-need products and services are generally required to be paid for in full in cash by the customer at the time of sale. Please see Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Cemetery Operations Pre-need Sales and At-need Sales.

Trusts

Sales of cemetery products and services are subject to a variety of state regulations. In accordance with these regulations, we are required to establish and fund two types of trusts, merchandise trusts and perpetual care trusts, to ensure that we can meet our future obligations. Our funding obligations are generally equal to a percentage of sales proceeds of the products and services we sell. For a detailed discussion of these trusts, please read Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Cemetery Operations Trusting.

Sales Personnel, Training and Marketing

As of December 31, 2006, we employed approximately 459 commissioned salespeople and 84 sales support and telemarketing employees. We have seven regional sales managers covering our cemeteries, who report to our Vice President of Sales. Individual salespersons are typically located at the cemeteries they serve and report directly to the cemetery manager. We have made a strong commitment to the ongoing education and training of our sales force and to salesperson retention in order to ensure that our customers receive the highest quality customer service. Our training program includes classroom training at our headquarters, field training, continuously updated training materials that utilize media, such as the Internet, for interactive training and participation in industry seminars. We place special emphasis on training property sales managers, who are key elements to a successful pre-need sales program.

We reward our salespeople with incentives for generating new customers. Sales force performance is evaluated by sales budgets, sales mix and closing ratios, which are equal to the number of contracts written divided by the number of presentations that are made. Substantially all of our sales force is compensated based solely on performance. Commissions are augmented with various bonus and incentive packages to ensure a high quality, motivated sales force. We pay commissions to our sales personnel based on a percentage of the price of the products and services, which varies from 8% to 24%, of the total contract price for pre-need sales and is generally equal to 5% of the total contract price for at-need sales. In addition, cemetery managers receive an override commission generally equal to 4% to 6% of the gross sales price of the contracts entered into by the salespeople assigned to the cemeteries they manage.

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We generate sales leads through focused telemarketing, direct mail, television advertising, funeral follow-up and sales force cold calling, with the assistance of database mining and other marketing resources. We have created a marketing department to allow us to use more sophisticated marketing techniques to more effectively focus our telemarketing and direct sales efforts. Sales leads are referred to the sales force to schedule an appointment, most often at the customer's home.

Acquisitions

On September 30, 2006 we completed the acquisition of 21 cemeteries and 14 funeral homes from Service Corporation International (NYSE: SCI) for \$11.8 million. We paid \$5.9 million in cash and 275,046 in Limited Partner units, representing the additional \$5.9 million. In addition, we assumed the merchandise and service liabilities associated with certain pre-arranged bonded contracts related to the properties.

The properties are located in Alabama (5 cemeteries and 3 funeral homes), Oregon (5 cemeteries and 6 funeral homes), Michigan (3 cemeteries), Kansas (2 cemeteries and 1 funeral home), Colorado (2 cemeteries), Washington (1 cemetery and 2 funeral homes), West Virginia (2 funeral homes), Kentucky (1 cemetery), Illinois (1 cemetery) and Missouri (1 cemetery). In the aggregate, the 21 cemeteries and 14 funeral homes annually perform approximately 4,300 interments and 2,000 calls, respectively. In 2005, these locations produced annual cemetery revenues of approximately \$9.9 million and annual funeral home revenues of approximately \$6.1 million.

We acquired two additional cemeteries during the fourth quarter of 2006 with an aggregate purchase price of approximately \$1.3 million.

Competition

Our cemeteries and funeral homes generally serve customers that live within a 10- to 15-mile radius of a property's location. Within this localized area, we face competition from other cemeteries and funeral homes located in the area. Most of these cemeteries and funeral homes are independently owned and operated, and most of these owners and operators are smaller than we are and have fewer resources than we do. We generally face limited competition from the three publicly held death care companies that have U.S. operations—Service Corporation International, Stewart Enterprises, Inc. and Carriage Services, Inc.—as they do not directly operate cemeteries in the geographic areas where we operate.

Within a localized area of competition, we compete primarily for at-need sales because many of the independently owned, local competitors either do not have pre-need sales programs or have pre-need programs that are not as developed as ours. Most of these competitors do not have as many of the resources that are available to us to launch and grow a substantial pre-need sales program. The number of customers that cemeteries and funeral homes are able to attract is largely a function of reputation and heritage, although competitive pricing, professional service and attractive, well maintained and conveniently located facilities are also important factors. The sale of cemetery and funeral home products and services on a pre-need basis has increasingly been used by many companies as an important marketing tool. Due to the importance of reputation and heritage, increases in customer base are usually gained over a long period of time.

Competitors within a localized area have an advantage over us if a potential customer's family members are already buried in the competitor's cemetery. If any of the three publicly held death care companies operated, or in the future were to operate, cemeteries within close proximity of our cemeteries, they may have a competitive advantage over us because they have greater financial resources available to them because of their size and access to the capital markets.

We believe that we currently face limited competition for cemetery acquisitions. The three publicly held death care companies identified above have historically been the industry's primary consolidators but have

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largely curtailed cemetery acquisition activity since 1999. Furthermore, these companies continue to generate a majority of their revenues from funeral home operations. Based on the relative levels of cemetery operations and funeral home operations of the three publicly traded death care companies, which are disclosed in their SEC filings, we are the only public death care company that focuses primarily on cemetery operations.

Robert B. Hellman Jr., who serves as one of our directors, as the Chief Executive Officer and a Managing Director of McCown De Leeuw & Co., LLC and in various other positions with McCown De Leeuw, has applied for a U.S. patent on a technology entitled, Apparatus and Method for Operating a Death Care Business as a Master Limited Partnership. The computer-implemented method defines death care master limited partnership assets based upon qualifying death care business income sources and non-qualifying death care business income sources. The pending patent application was filed on November 27, 2002, and claims priority to an earlier patent application filed November 30, 2001. The United States Patent and Trademark Office has not issued a communication regarding the substantive merits of the application. Mr. Hellman assigned the patent application to McCown De Leeuw & Co. IV, L.P. in February 2003 and recorded the assignment in the United States Patent and Trademark Office in March 2003. McCown De Leeuw & Co. IV, L.P. assigned a 50% ownership interest in the patent application and, if issued, the patent to the partnership. We cannot assure you that the patent will be issued or, if it is issued and subsequently challenged, that it will be determined to be valid.

If a patent is issued relating to this patent application, no other entity will be able to practice the claimed invention without the consent of McCown De Leeuw & Co. IV, L.P. and us. The patent will not prevent corporations, such as the three publicly held death care companies, or privately held partnerships that do not operate as master limited partnerships from competing with us in the death care business. As a result, the issuance of the patent is not expected to have a material impact on our business.

Regulation

General. Our operations are subject to regulation, supervision and licensing under federal, state and local laws.

Cooling-Off Legislation. Each of the states where our current cemetery properties are located has cooling-off legislation with respect to pre-need sales of cemetery and funeral home products and services. This legislation requires us to refund proceeds from pre-need sales contracts if canceled by the customer for any reason within three to thirty days, from the date of the contract, depending on the state.

Trusting. Sales of cemetery interment rights and pre-need sales of cemetery and funeral home merchandise and services are subject to trusting requirements imposed by state laws in all of the states where we operate. See Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Cemetery Operations Trusting.

Truth in Lending Act and Regulation Z. Our pre-need installment contracts are subject to the federal Truth-in-Lending Act, or TILA, and the regulations thereunder, which are referred to as Regulation Z. TILA and Regulation Z promote the informed use of consumer credit by requiring us to disclose, among other things, the annual percentage rate, finance charges and amount financed when extending credit to customers.

Do Not Call Implementation Act. We are subject to the requirements of two federal statutes governing telemarketing practices, the Telephone Consumer Protection Act, or TCPA, and the Telemarketing and Consumer Fraud and Abuse Prevention Act, or TCFAPA. These statutes impose significant penalties on those who fail to comply with their mandates. The Federal Communications Commission, or FCC, is the federal agency with authority to enforce the TCPA, and the Federal Trade Commission, or FTC, has jurisdiction under the TCFAPA. The FTC has established and implemented a national no-call registry under the TCFAPA. The legislation also establishes a private right of action for consumers against telemarketing entities under certain circumstances. The FCC has adopted regulations that mirror the no-call registry legislation. Primarily as a result

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of implementation of the do not call legislation, the percentage of our pre-need sales generated from telemarketing leads has decreased from 24% in 1999 to 11.0% in 2006. We are also subject to similar telemarketing consumer protection laws in the states of Alabama, Delaware, Georgia, Maryland, New Jersey, Ohio, Pennsylvania, Rhode Island, Tennessee, Virginia and West Virginia. These states' statutes permit consumers to prevent unwanted telephone solicitations.

Occupational Safety and Health. We are subject to the requirements of the federal Occupational Safety and Health Act, or OSHA, and comparable state statutes. The OSHA hazard communication standard, the Environmental Protection Agency community right-to-know regulations under Title III of the federal Superfund Amendment and Reauthorization Act and similar state statutes require us to organize information about hazardous materials used or produced in our operations. We may be subject to Tier 1 or Tier 2 Emergency and Hazardous Chemical Inventory reporting requirements depending on the amounts of hazardous materials kept onsite. Some of this information must be provided to employees, state and local governmental authorities and local citizens. We are also subject to the federal Americans with Disabilities Act and similar laws which, among other things, may require that we modify our facilities to comply with minimum accessibility requirements for disabled persons.

Federal Trade Commission. Our funeral home operations are comprehensively regulated by the Federal Trade Commission under Section 5 of the Federal Trade Commission Act and a trade regulation rule for the funeral industry promulgated thereunder referred to as the Funeral Rule. The Funeral Rule requires funeral service providers to disclose the prices for their goods and services as soon as the subject of price arises in a discussion with a potential customer (this entails presenting an itemized price list, referred to as the General Price List, if the consultation is in person, and readily answering all price-related questions posed over the telephone), and to offer their goods and services on an unbundled basis. Through these regulations, the Federal Trade Commission sought to give consumers the ability to compare prices among funeral service providers and to avoid buying packages containing goods or services that they did not want. The unbundling of goods from services has also opened the way for third-party, discount casket sellers to enter the market, although they currently do not possess substantial market share.

Future Enactments and Regulation. Federal and state legislatures and regulatory agencies frequently propose new laws, rules and regulations and new interpretations of existing laws, rules and regulations which, if enacted or adopted, could have a material adverse effect on our operations and on the death care industry in general. A significant portion of our operations are located in Pennsylvania, Virginia, Maryland, North Carolina and West Virginia and any material adverse change in the regulatory requirements of those states applicable to our operations could have a material adverse effect on our results of operations. We cannot predict the outcome of any proposed legislation or regulations or the effect that any such legislation or regulations, if enacted or adopted, might have on us.

Environmental Regulations and Liabilities

Our operations are subject to federal, state and local regulations in three principal areas: (1) crematories for emissions to air that may trigger requirements under the Clean Air Act, (2) funeral homes for the handling of hazardous materials and medical wastes and (3) cemeteries and funeral homes for the management of solid waste, underground and above-ground storage tanks and discharges to septic systems.

Clean Air Act. The Federal Clean Air Act and similar state and local laws, which regulate emissions into the air, can affect crematory operations through permitting and emissions control requirements. Our cremation operations are subject to Clean Air Act regulations under federal and state law and may be subject to enforcement actions if these operations do not conform to the requirements of these laws. In addition, the EPA anticipates the adoption of emissions restrictions to be enforced at the federal and state level for certain solid waste incinerators, including possibly crematory facilities, in the next few years. If the contemplated regulations and guidelines are adopted, we may be required to incur various costs in order to bring our facilities into compliance. We cannot assure you that the costs or liabilities will not be material in that event.

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Emergency Planning and Community Right-to-Know Act. Federal, state and local regulations apply to the use of hazardous materials at our funeral homes. Depending on the types and quantities of materials we handle at any particular location, we may be required to maintain and submit to authorities inventories of these materials present at that location in compliance with the Emergency Planning and Community Right-to-Know Act, or EPCRA.

Comprehensive Response, Compensation, and Liability Act. The Comprehensive Response, Compensation, and Liability Act, or CERCLA and similar state laws affect our cemetery and funeral home operations by, among other things, imposing cleanup liabilities for threatened or actual releases of hazardous substances that may endanger public health or welfare or the environment. Under CERCLA and similar state laws, joint and several liability may be imposed on waste generators, site owners and operators, and others regardless of fault or the legality of the original disposal activity. Our operations include the use of some materials that may meet the definition of hazardous substances under CERCLA and thus may give rise to liability if released to the environment through a spill or discharge. Should we acquire new properties with pre-existing conditions triggering CERCLA or similar state liability, we may become liable for responding to those conditions. We may become involved in proceedings, litigation or investigations at one or more sites where releases of hazardous substances have occurred, and we cannot assure you that the associated costs and potential liabilities would not be material.

Underground and Aboveground Storage Tank Laws and Solid Waste Laws. Federal and state laws regulate the installation, removal, operations and closure of underground storage tanks, or USTs and above-ground storage tanks ASTs, which are located at some of our facilities as well as the management of solid waste. Most of these USTs and ASTs contain petroleum for heating our buildings or are used for vehicle maintenance, or general operations. Depending upon the age and integrity of the USTs and ASTs, they may require upgrades, removal and/or closure, and remediation may be required if there has been a discharge or release of petroleum into the environment. All of the aforementioned activities may require us to incur costs to ensure continued compliance with environmental requirements. Should we acquire properties with existing USTs and ASTs that are not in compliance with environmental requirements, we may become liable for responding to releases to the environment or for costs associated with upgrades, removal and/or closure costs, and we can not assure you that the costs or liabilities will not be material in that event. Solid wastes have been disposed of at some of our cemeteries, both lawfully and unlawfully. Prior to acquiring a cemetery, an environmental investigation is usually conducted to determine, among other conditions, if a solid waste disposal area or landfill exists on the parcel which requires removal, cleaning or management. Depending upon the existence of any such solid waste disposal areas, we may be required by the applicable regulatory authority to remove the waste or to conduct remediation and we cannot assure you that the costs or liabilities will not be material in that event.

Employees

As of December 31, 2006 our general partner and its affiliates employed approximately 1,581 full-time and approximately 53 part-time employees. A total of 8 full time employees at one of our cemeteries located in New Jersey are represented by a union and are subject to collective bargaining agreements that expire in December 2009 and June 2011. An additional 38 employees at 11 of our cemeteries located in Pennsylvania are represented by four different unions and are subject to collective bargaining agreements that expire between June 2007 and June 2011. We believe that our relationship with our employees is good.

Available Information

We maintain an internet website with the address of <http://www.stonemor.com>. The information on this website is not, and should not be considered part of this annual report on Form 10-K and is not incorporated by reference into this document. This website address is only intended to be an inactive textual reference. Copies of our reports filed with, or furnished to, the SEC on Forms 10-K, 10-Q, and 8-K and any amendments to such reports are available for viewing and copying at such internet website, free of charge, as soon as reasonably practicable after filing such material with, or furnishing it to, the SEC.

Table of Contents**Item 6. Selected Financial Data**

On April 2, 2004, StoneMor was created to own and operate the cemetery and funeral home business conducted by Cornerstone. On September 20, 2004, in connection with StoneMor's initial public offering of common units, 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.

The following table presents selected financial and operating data of StoneMor's predecessor, Cornerstone, and of StoneMor for the periods and as of the dates indicated. The selected financial data for Cornerstone as of and for the years ended December 31, 2002 and 2003 are derived from the audited consolidated financial statements of Cornerstone. The selected financial data as of and for the year ended December 31, 2004, are derived from the audited consolidated financial statements of StoneMor, which comprise the operations of StoneMor from September 20, 2004 to December 31, 2004 and Cornerstone for the period January 1, 2004 to September 19, 2004, and the selected financial data as of and for the years ended December 31, 2005 and 2006 is derived from the audited consolidated financial statements of StoneMor.

The following table should be read together with, and is qualified in its entirety by reference to, the audited financial statements and the accompanying notes included in Item 8 of this Annual Report on Form 10-K. The table should also be read together with Management's Discussion and Analysis of Financial Condition and Results of Operation included in Item 7 of this Annual Report on Form 10-K.

| | Cornerstone Family Services, Inc. (1) | | | StoneMor Partners L.P. (1) | |
|---|---|-----------|-----------|-------------------------------|------------|
| | 2002 | 2003 | 2004 | 2005 | 2006 |
| | Year Ended December 31, (as restated (11)) | | | | |
| Statement of Operations Data: | | | | | |
| Cemetery revenues | \$ 74,168 | \$ 77,978 | \$ 87,305 | \$ 97,862 | \$ 108,995 |
| Funeral home revenues | 1,360 | 1,724 | 1,953 | 2,798 | 6,118 |
| Total Revenues | 75,528 | 79,702 | 89,258 | 100,660 | 115,113 |
| Cost of goods sold (exclusive of depreciation shown separately below): | | | | | |
| Land and crypts | 5,948 | 4,346 | 4,539 | 5,860 | 5,287 |
| Perpetual care | 2,434 | 2,585 | 2,692 | 2,575 | 3,109 |
| Merchandise | 3,634 | 3,123 | 5,143 | 5,463 | 6,296 |
| Selling expense | 15,413 | 15,584 | 19,158 | 20,072 | 23,186 |
| Cemetery expense | 17,191 | 17,732 | 19,648 | 20,942 | 24,344 |
| General and administrative expense | 9,020 | 9,407 | 9,797 | 10,553 | 12,801 |
| Overhead (including \$1,178 of stock-based compensation in 2003, \$433 in 2004 and \$1,212 in 2006) (2) | 12,544 | 12,672 | 12,658 | 16,304 | 19,795 |
| Depreciation and amortization | 4,893 | 5,001 | 4,547 | 3,510 | 3,501 |
| Funeral home expense | 1,343 | 1,513 | 1,712 | 2,382 | 4,836 |
| Total costs and expenses | 72,420 | 71,963 | 79,894 | 87,661 | 103,155 |
| Operating profit | 3,108 | 7,739 | 9,364 | 12,999 | 11,958 |
| Expenses related to terminated debt offering and refinancing (3) | | | 4,200 | | |
| Interest expense | 14,828 | 11,376 | 9,480 | 6,457 | 7,491 |
| Income (loss) before income taxes and cumulative effect of change in accounting principle | (11,720) | (3,637) | (4,316) | 6,542 | 4,467 |
| Income taxes (benefit) | | | | | |
| State | (178) | 1,362 | 663 | 587 | 438 |
| Federal | (1,453) | 1,010 | (1,141) | 1,250 | 989 |
| Total income taxes (benefit) | (1,631) | 2,372 | (478) | 1,837 | 1,427 |
| Income (loss) before cumulative effect of change in accounting principle | (10,089) | (6,009) | (3,838) | 4,705 | 3,040 |

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| | | | | | | |
|---|------------|------------|------------|----------|----------|--|
| Cumulative effect of change in accounting principle (4) | 5,934 | | | | | |
| Net Income (loss) | \$ (4,155) | \$ (6,009) | \$ (3,838) | \$ 4,705 | \$ 3,040 | |

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| | Cornerstone Family Services, Inc. (1) | | | StoneMor Partners L.P. (1) | |
|---|--|------------|------------|-------------------------------|------------|
| | Year Ended December 31, | | | | |
| | 2002 | 2003 | 2004 | 2005 | 2006 |
| Net income per limited partner (common) unit (basic and diluted) (5) | | | \$.27 | \$.54 | \$.34 |
| Balance Sheet Data (at period end): | | | | | |
| Cemetery property | \$ 153,413 | \$ 151,200 | \$ 150,215 | \$ 164,772 | \$ 171,714 |
| Total assets (6) | 377,720 | 381,230 | 523,092 | 550,641 | 627,026 |
| Deferred cemetery revenues, net (7) | 125,007 | 140,778 | 156,051 | 167,035 | 196,103 |
| Total debt | 134,732 | 130,708 | 80,000 | 86,945 | 103,492 |
| Redeemable preferred stock (par value \$0.01, 12,764 and 15,514 shares issued and outstanding at December 31, 2002 and 2003, respectively)(8) | 12,764 | 15,514 | | | |
| Total stockholders / partners equity | 48,920 | 41,980 | 115,317 | 109,600 | 101,288 |
| Cash Flow Data: | | | | | |
| Net cash provided by (used in): | | | | | |
| Operating activities | \$ 11,042 | \$ 7,146 | \$ 7,485 | \$ 17,589 | \$ 18,339 |
| Investing activities | (8,913) | (3,129) | (5,887) | (15,286) | (14,625) |
| Financing activities | 1,258 | (4,022) | 7,321 | (9,852) | (725) |
| Other Financial Data: | | | | | |
| Change in assets and liabilities that provided (used) cash: | | | | | |
| Merchandise trusts receivable | \$ 594 | \$ (128) | \$ | \$ | \$ |
| Due from merchandise trust | (1,379) | (170) | | | |
| Merchandise trusts | | | (1,333) | 10,473 | (3,517) |
| Merchandise liability | (3,427) | (3,224) | (7,397) | (7,224) | (8,109) |
| Capital expenditures: | | | | | |
| Maintenance capital expenditures | 3,378 | 1,184 | 2,620 | 2,192 | 2,059 |
| Expansion capital expenditures, including acquisitions and dispositions | 5,535 | 1,945 | 3,267 | 18,994 | 20,532 |
| Distributions declared per common unit in respect of the period | | | 0.5128 | 1.8625 | 1.9500 |
| Operating Data: | | | | | |
| Interments performed | 22,693 | 22,281 | 22,114 | 22,263 | 26,003 |
| Cemetery revenues per interment performed (9) | \$ 3,215 | \$ 3,500 | \$ 3,948 | \$ 4,396 | \$ 4,192 |
| Interment rights sold (10): | | | | | |
| Lots (9) | 11,933 | 12,442 | 12,136 | 12,758 | 13,769 |
| Mausoleum crypts (including pre-construction) | 2,271 | 2,314 | 2,224 | 2,163 | 2,361 |
| Niches | 436 | 445 | 442 | 409 | 440 |
| Total interment rights sold (9)(10) | 14,640 | 15,201 | 14,802 | 15,330 | 16,570 |
| Cemetery revenues per interment right sold (9)(10) | \$ 4,984 | \$ 5,130 | \$ 5,889 | \$ 6,384 | \$ 6,578 |
| Number of contracts written | 51,012 | 47,939 | 46,149 | 46,510 | 54,675 |
| Aggregate contract amount, in thousands (excluding interest) | \$ 89,106 | \$ 90,551 | \$ 91,983 | \$ 96,642 | \$ 116,407 |
| Average amount per contract (excluding interest) | \$ 1,747 | \$ 1,889 | \$ 1,993 | \$ 2,078 | \$ 2,129 |
| Number of pre-need contracts written | 23,194 | 22,276 | 21,079 | 21,306 | 24,999 |
| Aggregate pre-need contract amount, in thousands (excluding interest) | \$ 59,177 | \$ 60,854 | \$ 60,040 | \$ 63,415 | \$ 74,301 |
| Average amount per pre-need contract (excluding interest) | \$ 2,551 | \$ 2,732 | \$ 2,848 | \$ 2,976 | \$ 2,972 |
| Number of at-need contracts written | 27,818 | 25,663 | 25,070 | 25,204 | 29,676 |
| Aggregate at-need contract amount, in thousands | \$ 29,928 | \$ 29,698 | \$ 31,943 | \$ 33,227 | \$ 42,106 |
| Average amount per at-need contract | \$ 1,076 | \$ 1,157 | \$ 1,274 | \$ 1,318 | \$ 1,419 |

(1) Includes results of operations of cemeteries that we operate under management agreements with the cemetery associations that own them. Prior to September 2004 we operated 12 cemeteries under management agreements and have subsequently converted five of these cemetery associations (one in September 2004 and 4 in April 2005) into for-profit entities owned by us and ceased operating these cemeteries under management agreements.

(2) Includes write-off of \$1.3 million of expenses in 2002 and \$715,000 in 2003 incurred in connection with a potential acquisition of a group of cemeteries in Michigan that we determined would be unlikely to take place. Also includes \$1.7

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- million in bonuses in 2003, \$1.5 million in bonuses in 2004, \$2.0 million in bonuses in 2006, an annual payment of \$0.4 million to \$0.8 million in management fees to MDC Management Company IV, LLC from 2001 to 2004, and \$1.2 million of stock-based compensation in 2003, \$0.4 million of stock based compensation in 2004 and \$1.2 million of stock based compensation in 2006, and \$883,000 in reserves for the write-off of our investment in a management agreement at one of our locations that was terminated subsequent to year-end 2006.
- (3) In 2004 represents expenses incurred in connection with the refinancing of our debt in connection with our initial public offering in September 2004. These expenses include a \$3.9 million write-off of debt issuance costs and \$0.3 million of expenses related to early extinguishment of debt.
 - (4) In 2002, represents negative goodwill recorded as a result of the implementation of SFAS Nos. 141 and 142.
 - (5) In 2004 represents the net income per common unit (basic and diluted) from September 20, 2004, the date of our initial public offering, through December 31, 2004.
 - (6) Includes principal of perpetual care and merchandise trusts stated on our balance sheet at fair value as of December 31, 2004 in accordance with FASB Interpretation No. 46 and No. 46 revised, *Consolidation of Variable Interest Entities: an Interpretation of Accounting Research Bulletin No. 51*, which we adopted as of March 31, 2004. In previous periods, includes principal held in merchandise trusts stated on our balance sheets at cost and does not include perpetual care trust principal in accordance with then industry practice.
 - (7) Represents revenues to be recognized from sales of pre-need products and services and the related income and capital gains on merchandise trusts. We recognize revenues from sales of pre-need interment rights to constructed mausoleums when we have collected at least 10% of the sales price. We defer recognition of revenues from sales of pre-need interment rights to unconstructed mausoleums until we have collected at least 10% of the sales price, at which point we recognize revenues on the percentage-of-completion basis. We recognize revenues from sales of pre-need merchandise and services, other than perpetual care services, when we satisfy the criteria for delivery of the merchandise to the customer or perform the services for the customer. At that time, we also recognize the related income and capital gains from merchandise trusts. See Management's Discussion and Analysis of Financial Condition and Results of Operations Overview Cemetery Operations Sources of Revenues and Trusting.
 - (8) Represents shares of preferred stock issued to the McCown De Leeuw funds and members of management that were converted into Class A membership interests of CFSI LLC prior to our initial public offering.
 - (9) Excludes in 2002 the sale of a tract of developed land equivalent to 9,600 burial lots to a municipality in Pennsylvania for \$1.2 million and in 2005 the sale of a tract of land equivalent to 1,881 burial lots to a municipality in New Jersey for \$1.7 million.
 - (10) Net of cancellations. Counts the sale of a double-depth burial lot as the sale of two interment rights.
 - (11) See Note 2 to the consolidated financial statements.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

You should read the following discussion of our financial condition and results of operations in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this Annual Report on Form 10-K. Those notes also give more detailed information regarding the basis of presentation for the following information.

The following management's discussion and analysis reflects the restatement discussed in Note 2 to the accompanying financial statements.

Forward-Looking Statements

Certain statements contained in this annual report, including, but not limited to, information regarding the status and progress of the Company's operating activities, the plans and objectives of the Company's management, assumptions regarding the Company'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 words believe, may, will, estimate, continues, anticipate, intend, project, expect, anticipate, predict, and similar expressions identify forward-looking 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: uncertainties associated with future revenue and revenue growth; the impact of the Company's significant leverage on its operating plans; the ability of the Company to service its debt; the Company'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; the Company'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 from Service Corporation International and various other uncertainties associated with the deathcare industry and the Company's operations in particular.

When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements set forth under Risk Factors in Part 1, Item 1A and Regulatory and Legal Risks. 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 was created to own and operate the cemetery and funeral home business conducted by Cornerstone. 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.

As of December 31, 2006, the Company operated 177 cemeteries in 21 states, located primarily in the eastern United States. The Company owns 170 of these cemeteries and operates the remaining 7 under long-term management agreements with cemetery associations that own the cemeteries. As a result of the agreements and other control arrangements, we consolidate the results of the 7 managed cemeteries in our historical consolidated financial statements. We also own and operate 27 funeral homes in 9 states.

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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 year ended December 31, 2006, StoneMor performed over 26,000 burials and sold more than 21,100 interment rights (net of cancellations) compared to 22,300 and 18,500, respectively for the same period of 2005.

Initial Public Offering. 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 42.5% interest in us. On September 22, 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. As described in the partnership agreement, during the subordination period the subordinated units are not entitled to receive any distributions until the common units have received their minimum quarterly distribution plus any arrearages from prior quarters. The subordination period will end once the partnership meets certain financial tests described in the partnership agreement, but it generally cannot end before September 30, 2009. When the subordination period ends, all subordinated units will convert into common units on a one-for-one basis, and the common units will no longer be entitled to arrearages. If the partnership meets certain financial tests described in the partnership agreement, 25% of the subordinated units can convert into common units on or after September 30, 2007 and an additional 25% can convert into common units on or after September 30, 2008. Concurrent with the initial public offering, the Partnership's wholly owned subsidiary, StoneMor Operating LLC and its subsidiaries (collectively StoneMor LLC), all as borrowers, issued new 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 and \$15.7 million of fees and expenses associated with the initial public offering and the sale of senior secured notes. The remaining funds were reserved for general partnership purposes, including the construction of mausoleum crypts and lawn crypts and the purchases of equipment needed to install burial vaults. One-half of the net proceeds of the sale of common units upon the exercise of the over-allotment option was used to redeem an equal number of common units from CFSI LLC, and one-half has been reserved for general Partnership purposes. The proceeds received by the Partnership and its subsidiaries from the sales of common units and senior secured notes and the use of these proceeds is summarized as follows (in thousands):

| | |
|--|------------|
| Proceeds received: | |
| Sale of 4,226,250 common units at \$20.50 per unit | \$ 86,638 |
| Issuance of senior secured notes | 80,000 |
| | |
| Total proceeds received | \$ 166,638 |
| Use of proceeds from sale of common units | |
| Underwriting discount | \$ 5,849 |
| Professional fees and other offering costs | 9,542 |
| Repayment of debt and accrued interest | 56,361 |
| Redemption of 551,250 units from CFSI LLC | 5,255 |
| Construction of mausoleum and lawn crypts, purchase of burial vault installation equipment, and reorganization taxes | 5,098 |
| Acquisition of cemetery and funeral home locations | 4,533 |
| | |
| Total use of proceeds from the sale of common units | \$ 86,638 |
| Use of proceeds from the issuance of senior secured notes | |
| Debt issuance costs | \$ 1,076 |
| Other related costs | 215 |
| Repayment of debt | 78,709 |
| | |
| Total use of proceeds from the issuance of senior secured notes | 80,000 |
| | |
| Total use of proceeds | \$ 166,638 |

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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

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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 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 those sales. 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.

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Revenues by State. The following table shows the percentage of revenues attributable to each of the states in which we operate for the periods presented:

| | Year Ended December 31, | | |
|----------------|-------------------------|--------|--------|
| | 2004 | 2005 | 2006 |
| Pennsylvania | 30.3% | 29.3% | 29.0% |
| New Jersey | 15.2% | 18.1% | 15.9% |
| Virginia | 19.5% | 16.0% | 15.4% |
| West Virginia | 13.8% | 14.4% | 11.0% |
| Maryland | 11.7% | 12.8% | 10.9% |
| Ohio | 5.2% | 5.2% | 5.8% |
| North Carolina | 0.0% | 0.4% | 5.5% |
| Alabama | 1.2% | 0.8% | 1.9% |
| Georgia | 0.1% | 0.2% | 1.8% |
| Tennessee | 1.9% | 1.8% | 0.9% |
| Missouri | 0.0% | 0.0% | 0.3% |
| Oregon | 0.0% | 0.0% | 0.3% |
| Connecticut | 0.5% | 0.6% | 0.3% |
| Kansas | 0.0% | 0.0% | 0.2% |
| Michigan | 0.0% | 0.0% | 0.2% |
| Delaware | 0.3% | 0.2% | 0.2% |
| Rhode Island | 0.3% | 0.2% | 0.2% |
| Illinois | 0.0% | 0.0% | 0.1% |
| Kentucky | 0.0% | 0.0% | 0.1% |
| Colorado | 0.0% | 0.0% | 0.0% |
| Washington | 0.0% | 0.0% | 0.0% |
| Total | 100.0% | 100.0% | 100.0% |

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Principal Products and Services. The following table shows the percentage of revenues attributable to our principal products, services and other items during the periods presented:

| | Year Ended December 31, | | |
|---|-------------------------|---------------|---------------|
| | 2004 | 2005 | 2006 |
| Pre-need sales: | | | |
| Burial lots | 6.7% | 7.4% | 7.5% |
| Mausoleum crypts | 7.5% | 9.4% | 8.1% |
| Markers | 7.4% | 6.1% | 5.1% |
| Grave marker bases | 2.2% | 2.0% | 1.6% |
| Burial vaults | 5.1% | 4.8% | 6.3% |
| Lawn crypts | 0.6% | 0.5% | 0.2% |
| Caskets | 5.7% | 7.0% | 3.9% |
| Initial openings and closings (1) | 5.9% | 5.3% | 7.1% |
| Other (2) | 2.5% | 2.5% | 3.1% |
| Total pre-need sales | 43.6% | 45.0% | 42.9% |
| Interest from pre-need installment contracts | 4.7% | 3.8% | 3.6% |
| Investment income from trusts: | | | |
| Perpetual care trusts | 8.1% | 7.7% | 8.3% |
| Merchandise trusts | 5.6% | 6.4% | 5.2% |
| Total investment income from trusts | 13.7% | 14.1% | 13.5% |
| At-need sales: | | | |
| Openings and closings (3) | 13.4% | 12.3% | 12.9% |
| Markers | 7.5% | 7.2% | 8.1% |
| Burial lots | 3.1% | 2.9% | 3.3% |
| Mausoleum crypts | 2.0% | 1.8% | 1.6% |
| Grave marker bases | 2.5% | 2.4% | 2.5% |
| Foundations and inscriptions (4) | 1.6% | 1.5% | 1.5% |
| Burial vaults | 1.3% | 1.3% | 1.3% |
| Other (5) | 1.3% | 1.3% | 1.5% |
| Total at-need sales | 32.7% | 30.7% | 32.7% |
| Funeral home revenues | 2.2% | 2.8% | 5.3% |
| Other revenues (6) | 3.1% | 3.6% | 2.0% |
| Total revenues | 100.0% | 100.0% | 100.0% |

(1) Installation of the burial vault into the ground.

(2) Includes revenues from niches, mausoleum lights, cremations, pet cemeteries, installation of burial vaults and markers sold to our customers by third parties and pre-need sales made in connection with the relocation of other cemetery interment rights. Also includes document processing fees on pre-need contracts and fees from sales of travel care protection, which covers shipping costs of a body if death occurs more than 100 miles from the place of residence.

(3) Installation of the burial vault into the ground and the placement of the casket into the vault.

(4) Installation of the marker on the ground and its inscription.

(5) Includes revenues from lawn crypts, decorative lights installed on mausoleum crypts, installations of burial vaults and markers sold to our customers by third parties and cremation fees. Also includes document-processing fees on at-need contracts.

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- (6) Includes sales of manufactured burial vaults to third parties, sales of cemetery and undeveloped land, commissions from sales of pre-need funeral policies and death benefit policies provided through a third-party insurance provider and other miscellaneous revenue.

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Pre-need Sales. Pre-need products and services are typically sold on an installment basis with terms ranging from 12 months to 84 months, with an average of 37 months. Our pre-need contracts are subject to cooling-off periods, generally between three and thirty days, required by state law during which the customer may elect to cancel the contract and receive a full refund of amounts paid. Subject to applicable state law, if customers cancel after the cooling-off period, we are generally permitted to retain the amounts already paid on contracts, including any amounts that were required to be deposited into trust. Historically, our customers have cancelled contracts representing approximately 10% of our pre-need sales (based on contract dollar amounts) after the cooling-off period. If the products and services purchased under a pre-need contract are needed for interment before payment has been made in full, generally the balance due becomes immediately due and must be paid in cash.

Approximately 54% of our pre-need sales contracts do not bear interest. Historically, we did not charge interest on pre-need sales contracts having a term of 12 months or less, and during 2005, we did not charge interest on contracts with a term of 24 months or less. In those cases, interest is imputed at varying market rates, currently 8.75%. The interest rates on our interest-bearing pre-need contracts range from 6% to 13%, with a weighted average interest rate of 7%. We offer prepayment incentives to customers whose pre-need contracts are longer than 36 months and bear interest. If those customers pay their contracts in full in less than 12 months, we rebate the interest that we collected from them. Even though this rebate policy reduces the amount of interest income we receive on our accounts receivable, the net effect is an increase in our immediate cash flow. Interest income from pre-need sales, including imputed interest, accounted for 3.3% of our 2006 revenues.

Trusting. We are generally required by state law to place a portion of the sales price of cemetery interment rights, whether at-need or pre-need, into a perpetual care trust to maintain the cemetery property in perpetuity. The amount that we are required to deposit into a perpetual care trust varies from state to state but is generally 10% to 15% of the sales price of the interment right. As payments are received from the customer, we deposit a pro rata amount of the payment into a perpetual care trust. For example, if we receive a payment of 20% of the sales price from the customer, we would deposit into the perpetual care trust 20% of the total amount required to be placed into trust for that sale.

Under the state laws that require the creation of the perpetual care trusts, we are not permitted to withdraw the trust principal, and our creditors and customers have no right to make claim to the funds deposited into these trusts. Amounts held in these perpetual care trusts are invested by third-party investment managers as discussed in more detail below. As a result, we do not possess legal title to the trust principal in these perpetual care trusts; however, in accordance with current industry practice, amounts deposited into perpetual care trusts are reflected at fair market value on the asset portion of our balance sheet as of December 31, 2006 as an asset entitled perpetual care trusts, restricted, at fair value, and an equal amount is reflected on the liabilities, preferred stock and common stockholders equity portion of our balance sheet as an item entitled non-controlling interest in perpetual care trusts. For periods ending before March 31, 2004, we did not include perpetual care trust principal on our balance sheet in accordance with prior industry practice. We recognize income from perpetual care trusts in our revenues as it is earned in the trust, regardless of when we withdraw it. We are permitted under state law to withdraw the investment income, such as interest and dividends, but not the capital gains, from perpetual care trusts, generally on a monthly basis. To maximize the income generated by perpetual care trusts, we have established investment guidelines for the third-party investment managers so that substantially all of the funds held in perpetual care trusts are invested in intermediate-term, investment-grade, fixed-income securities, high-yield fixed-income securities and real estate investment trusts. We are required to use all amounts withdrawn from perpetual care trusts for cemetery maintenance and administration.

We are generally required by state law to deposit a portion of the sales price of pre-need cemetery merchandise and services, or the estimated current cost of providing that merchandise and those services, into a merchandise trust to ensure that we will have sufficient funds in the future to purchase the merchandise or perform the services. The amount we are required to deposit into a merchandise trust varies from state to state but is generally 40% to 70% of the sales price of the merchandise or services. As payments are received from the

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customer, we deposit a pro rata amount of the payment into the merchandise trust. For example, if we receive a payment of 20% of the sales price from the customer, we would deposit into the merchandise trust 20% of the total amount required to be placed into trust for the merchandise and services sold.

Under the state laws that require the creation of the merchandise trusts, we are not permitted to withdraw the trust principal, except as described below, and our creditors and customers have no right to make claim to the funds deposited into these trusts. Amounts held in these merchandise trusts are invested by third-party investment managers as discussed in more detail below. As a result, we do not possess legal title to the trust principal in these merchandise trusts; however, in accordance with current industry practice, amounts deposited into merchandise trusts are reflected at fair value on our balance sheet as of December 31, 2006 as an asset called "merchandise trusts, restricted, at fair value". For periods ending prior to March 31, 2004, amounts deposited into merchandise trust were reflected at cost on our balance sheet as an asset called "due from merchandise trust", in accordance with prior industry practice. Earnings on funds held in merchandise trusts, including investment income and capital gains, are included separately on our balance sheet in deferred cemetery revenues, net. These amounts remain on our balance sheet until we recognize them as revenues. We recognize amounts withdrawn from merchandise trusts, including principal, as revenues when we satisfy the criteria for delivery of the related merchandise or perform the related services.

We are permitted to withdraw the investment income, such as interest and dividends, as well as capital gains, from merchandise trusts at varying times depending on the applicable state law. In most states, we are permitted to make monthly withdrawals of investment income, but in other states we are permitted to withdraw income less frequently or only upon death. In all states, however, we are permitted to withdraw trust principal and earnings to purchase the merchandise or perform the services or, generally, when the customer cancels the contract. We invest the amounts deposited into merchandise trusts, within specified investment guidelines, primarily in intermediate-term, investment-grade fixed-income securities, high-yield fixed-income securities, real estate investment trusts and, to a lesser extent, equity securities and cash.

The income earned on funds held in perpetual care trusts and merchandise trusts can be materially affected by fluctuations in interest rates and, in the case of merchandise trusts, by the performance of the stock market to the extent that the funds held in merchandise trusts are invested in equity securities. Earnings on merchandise and perpetual care trusts that we recognized as revenues accounted for 13.6% of our 2006 revenue. During 2004, 2005 and 2006 our average annual rates of return from realized earnings on funds held in merchandise trusts were 9.0%, 7.1% and 7.6%, respectively, and our average annual rates of return from realized earnings on funds held in perpetual care trusts were 6.1%, 6.0% and 6.3%, respectively. We cannot assure you, however, that that we will continue to be successful in achieving any particular return in the future.

Amounts held in trusts are invested by third-party investment managers who are selected by the Trust and Compliance Committee of our board of directors. These investment managers are required to invest our trust funds in accordance with applicable state law and internal investment guidelines adopted by our Trust and Compliance Committee. Our investment managers are monitored by third-party investment advisors selected by our Trust and Compliance Committee who advise the Committee on the determination of asset allocations, evaluate the investment managers and provide detailed monthly reports on the performance of each merchandise and perpetual care trust.

Unrealized gains and losses in merchandise trusts have no immediate impact on our revenues, earnings or cash flow unless the fair market value of the funds declines below the estimated costs to deliver the related products and services, in which case we would be required to record a current charge to earnings equal to the difference between the fair market value of the funds and the estimated costs. Over time, gains and losses realized in merchandise trusts are allocated to the underlying pre-need contracts and affect the amount of trust earnings to be recognized as revenues when we deliver the related products or perform the related services. As of December 31, 2006, the aggregate fair market value of funds held in merchandise trusts exceeded our costs to purchase the related products and perform the related services by \$102.0 million.

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At the time we enter into a pre-need contract, we determine both the amount required to be deposited into a merchandise trust and our cost to purchase the related products and perform the related services. We determine the amount required to be deposited into a merchandise trust based on applicable state law. We determine our cost to purchase a product using the actual current cost of the product as indicated on the price list from the manufacturer at the time we enter into the pre-need contract. We determine our cost to perform a service based on the current cost of the labor necessary to perform the service at the time we enter into the pre-need contract. We are able to control the cost of the vaults we are required to purchase by manufacturing most of those vaults. We are also able to control the cost to perform services, such as openings and closings, by purchasing the necessary equipment and using our employees to perform these services for us.

Our cost to purchase any product or to perform any service is generally less than 30% of the retail price of such product or service. The retail price is the price at which we sell the product or service to our customers. Because each state in which we operate requires us to deposit into a merchandise trust an amount equal to at least 30% of the retail price (and usually a greater percentage) of the related products and services, our cost to purchase these products and perform those services is generally less than the amount required to be deposited in trust.

As of December 31, 2006, approximately 44.7% of the fair market value of the amounts held in merchandise trusts was invested in fixed-income securities to ensure that the market value of those funds will be sufficient to cover our cost to purchase the related products and perform the related services at the time of purchase and performance.

Some states impose additional restrictions on our ability to withdraw merchandise trust earnings if those trusts have realized losses. For example, if a Pennsylvania merchandise trust realizes a loss, the trust is required to recover the amount of the realized loss, either by earning income or generating capital gains, before we are allowed to withdraw earnings, except to purchase the related products or perform the related services. Other states, such as Virginia, permit continued withdrawals of merchandise trust earnings following a realized loss so long as the fair market value of the funds held in trust equals or exceeds the cost of the related products and services.

Cash Flow. The impact of pre-need sales on near-term cash flow depends primarily on the commissions paid on the sale, the portion of the sales price required to be deposited into trust and the terms of the particular contract, such as the amount of the required down payment, the products purchased and the length of the contract. Customers are required to make a down payment on a pre-need contract of at least 5% of the total sales price, with the average down payment equal to 12.5% of the total sales price. When we receive a payment from a customer on a pre-need contract, we first deposit the requisite portion into trust as required by state law. Then, we pay all or a portion of the commission due to the salesperson responsible for the sale. We generally pay commissions to our pre-need sales personnel based on a percentage, usually 8% to 24%, of the total sales price, but only to the extent that cash is received from the customer. If the down payment received from the customer is not sufficient to cover the entire commission, the remaining commission is paid from subsequent installments, but only to the extent of 80% of the cash received from the customer in each installment. Because we are required to deposit a portion of each installment into trust, we are usually required to use our own cash to cover a portion of the commission due to the salesperson. Accordingly, pre-need sales are generally cash flow negative initially but become cash flow positive at varying times over the life of the contract, generally six to seven months after the down payment is made, depending upon the trust requirements, the terms of the particular contract, the sales commission paid and the timing of delivery or performance of the related products and services.

For example, on a pre-need contract with a total sales price of \$1,000, a 10% down payment, a 40% perpetual care and merchandise trusting requirement, a 15% sales commission and a one-year term without interest, our short-term cash flow would be as follows:

When we receive the \$100 down payment from the customer, we would deposit 40% of the payment, or \$40 in trust and pay 100% of the commission due to the salesperson, or \$150, but only to the extent

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that we received cash from the customer, or \$100. Our total cash obligations would be \$140 even though we only received \$100 from the customer. We would use \$40 of our operating cash to pay the sales commission and, at this time, would be cash flow negative on the contract.

In month one, when we receive the first \$75 installment from the customer, we would deposit 40%, or \$30, into trust and pay 100% of the balance of the commission due to the sales person, or \$50. Our total cash obligations would be \$80 even though we only received \$75 from the customer. We would use \$5 of our operating cash to pay sales commission and would still be cash flow negative on the contract.

In month two, when we receive the next \$75 installment from the customer, we would deposit 40%, or \$30, into trust, but we would have no further commission due on the sale. The remaining \$45 received from the customer would go back into our operating cash, and we would break even on the contract on a cash-flow basis.

In month three, when we receive the next \$75 installment from the customer, we would deposit 40%, or \$30, into trust and the remaining \$45 would go back into our operating cash. In this month, we would become cash flow positive on the contract.

We can enhance our operating cash flow by purchasing and delivering many of our products in advance of the time of customer need, either by installing them in the customer's burial space (in the case of burial vaults) or storing them for the customer, and by performing certain services prior to the time of need. For example, within the allowances of state law, we purchase burial vaults, grave markers and caskets, and perform initial openings and closings to install the burial vault in the ground before the time of need. When we satisfy the criteria for delivery of pre-need products or perform pre-need services, we are permitted to withdraw the related principal and any income and capital gains that we have not already withdrawn from the merchandise trust, and we recognize the amounts withdrawn, including amounts previously withdrawn, as revenues. Advance purchasing helps us avoid the negative cash flow impact of depositing significant portions of our sales proceeds in trusts while earning rates on those trusts that are currently less than interest rates we pay on our debt. To the extent that we can purchase and deliver products and perform services in advance of the time of need, we can accelerate, within the limitations of GAAP, the timing of our revenue recognition for these products and services. As a result, decisions made by our management to purchase and deliver products or perform services in advance, for cash flow or other reasons, affects the timing of revenue recognition from the underlying sales.

In 1999 and 2000, the rates of return on funds held in merchandise and perpetual care trusts generally exceeded the interest rates on our outstanding debt. We focused on increasing our assets by holding the funds deposited in merchandise and perpetual care trusts until the time of need and borrowing under our credit facility any cash needed for our operations. In 2001, however, market conditions changed, and the interest rates on our outstanding debt generally exceeded our rates of return on funds held in merchandise and perpetual care trusts. We began to consider alternative methods for increasing our cash flow in response to these declining rates of return. By 2003, we had adjusted our cash flow management to accelerate the withdrawal of funds from merchandise trusts, within the limitations of applicable state law, and to purchase and deliver pre-need products and perform pre-need services in advance of the time of need. We used the amounts withdrawn from merchandise trusts, after deducting our costs to purchase the related products and perform the related services, to service our outstanding debt and operate our business. The availability of these withdrawn funds for our operations reduced the amount of additional borrowings we otherwise would have been required to make under our credit facility, and we did not incur the interest expense that would have been associated with those borrowings.

We are somewhat limited, however, in our ability to purchase some products in advance of the time of need because of their availability. Given our large volume of pre-need sales, it is unlikely that our suppliers could provide, or we could manufacture, all of the products included in our pre-need backlog at any given time. For example, we generally need over 20,000 vaults per year to fulfill our pre-need contract obligations, of which we manufacture approximately 18,000 at our plant. We must purchase any excess from third party suppliers who must also meet the demands of other cemetery operators.

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We currently purchase burial vaults from third-party providers to assist us in meeting the demands of our accelerated purchase and delivery program. We are also limited in our ability to perform certain services in advance of the time of need because of their nature or our resources. For example, we cannot perform the final opening and closing, which is the placing of the casket into the ground, or inscribe the date of death on the monument or marker until the time of need. Even if we chose to perform all of the services in our pre-need backlog that could be performed in advance of need, such as installing all of the burial vaults in our pre-need backlog, we would not currently have the labor, equipment or other resources to perform all of those services in a short period of time.

At-need Sales. At-need sales of products and services are generally required to be paid for in full with cash at the time of sale. At that time, we first deposit any amount required to be placed in perpetual care trusts. Then we pay commissions, which are usually equal to 5% of the total sales price, to our sales personnel. We are not required to deposit any amounts from our at-need sales into merchandise trusts.

Expenses. Our primary variable operating costs are cost of goods sold and selling expenses. Cost of goods sold reflects the actual cost of purchasing products and performing services and averaged from 20% to 25% of the related sales price for the last three years. Selling expense consists of salesperson and sales management payroll costs, including selling commissions, bonuses and employee benefits, and other costs of obtaining product and service sales, such as advertising, marketing, postage and telephone. Selling expense also includes override commissions paid to our cemetery managers based on the volume of sales made for the cemeteries they manage. Override commissions are generally 4% to 6% of gross sales price and are payable weekly. Selling expense has historically averaged between 36% and 41% of product and service sales.

Additionally, we self-insure medical expenses of our employees up to certain individual and aggregate limits after which our insurer is responsible for additional medical expenses. Our self-insurance policy may result in variability in our future operating expenses.

In addition to our variable operating expenses, we incur fixed costs, primarily for cemetery expense, depreciation of property and equipment and general and administrative expense for our cemeteries. Cemetery expense represents the cost to maintain and repair our cemetery properties and consists primarily of labor and equipment, utilities, real estate taxes and other maintenance items. Repairs necessary to maintain our cemeteries are expensed as they are incurred. Other maintenance costs required over the long term to maintain the operating capacity of our cemeteries, such as to build roads and install sprinkler systems, are capitalized. We depreciate our property and equipment on a straight-line basis over their estimated useful lives. General and administrative expense, which does not include corporate overhead, includes primarily insurance and other costs necessary to maintain our cemetery offices.

Direct costs associated with pre-need sales of cemetery merchandise and services, such as sales commissions and cost of goods sold, are reflected in the balance sheet in deferred selling and obtaining costs and deferred cemetery revenues, net, respectively and are expensed as the merchandise is delivered or the services are performed. Indirect costs, such as marketing and advertising costs, are expensed in the period in which they are incurred.

Sales of cemetery lots and interment rights, whether at-need or pre-need, typically generate a higher profit margin than the other products and services we sell. This is primarily because our cost of goods sold is lower on these sales. When we purchase cemetery property, we allocate the purchase price to the property based on the number of burial lots. As we recognize revenues from sales of interment rights or land, we expense the cost of the associated lots as the cost of goods sold.

Outlook. We believe that in order to expand our cemetery operations, we must attract new customers, continue to attract and hire talented sales personnel and management and enhance our current marketing department to generate additional pre-need sales. Our principal target market is the 45-to 64-year-old category

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because this age group typically purchases pre-need products and services at a higher rate than younger age groups. This target age group is expected to experience a 2.6% compounded annual growth rate from 2000 to 2010, or approximately three times the annual growth rate for the public overall. We believe that the aging of the baby boom generation will more than offset the impact of increased life expectancy.

We believe that competition experienced by individual cemetery properties is generally limited to existing cemeteries within the same area. Competition from new entrants is minimized by the significant barriers to establishing a new cemetery in any particular location, including the availability of land, compliance with local regulatory requirements and the significant start-up capital costs, such as paving roads and installing sprinkler systems. Heritage and tradition also make it difficult to establish a new cemetery, as existing cemeteries have often served multiple generations of families and have developed strong family loyalty.

The death care industry is facing challenges, however, including an increasing trend toward cremation and difficulty in attracting and retaining high quality sales and management personnel to the industry.

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 Limited Partner units, representing the additional \$5.9 million. In addition, StoneMor will assume the merchandise and service liabilities associated with certain pre-arranged bonded contracts related to the properties. Additionally, on September 30, 2006 we completed the acquisition of 21 cemeteries and 14 funeral homes from Service Corporation International (NYSE: SCI) for \$11.8 million. We paid \$5.9 million in cash and 275,046 in Limited Partner units, 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.

We intend to continue to expand our operations through accretive acquisitions of high-quality cemetery properties. However, our valuations of potential acquisitions of high-quality cemeteries may be below the current sellers' expectations, which may make it more difficult for us to complete acquisitions of desired properties on terms acceptable to us, or at all. Furthermore, we are not permitted to make acquisitions for more than \$2.5 million, or any series of acquisitions aggregating more than \$20.0 million in any consecutive 12-month period, without the requisite consent of the lenders under our credit facility. In addition, we may face competition for future acquisitions because several large death care companies have recently announced their intention to resume some level of acquisition activity. When we acquire cemeteries that do not have an existing pre-need sales program or a significant amount of pre-need products and services that have been sold but not yet delivered or performed, the operation of the cemetery and implementation of a pre-need sales program after acquisition may require significant amounts of working capital. This may make it more difficult for us to make accretive acquisitions.

Funeral Home Operations

We derive revenues at our funeral homes 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. We sell these services and merchandise almost exclusively at the time of need utilizing salaried licensed funeral directors. In 2006, our funeral home revenues accounted for approximately 5.3% of our revenues. More than 1,330 funerals were performed at our funeral homes in 2006.

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.

Our other funeral home operating expenses consist primarily of compensation to our funeral directors and the cost of caskets.

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Other

Corporate Overhead. We incur fixed costs for corporate overhead primarily for centralized functions, such as payroll, accounting, collections and professional fees. We also incur expenses relating to reporting requirements under U.S. federal securities laws and certain other additional expenses of being a public company. During 2006, our expenses related to being a public company totaled \$2.5 million of which, \$0.9 million was related to costs of compliance with the Sarbanes-Oxley Act of 2002.

Consolidation. Our historical operations are part of a consolidated group for financial reporting purposes that includes the cemeteries we operate under long-term management contracts with the cemetery associations that own the cemetery properties. Prior to September 2004 we operated 12 cemeteries under management agreements and have subsequently converted five of these cemetery associations (one in September 2004 and 4 in April 2005) into for-profit entities owned by us and ceased operating these cemeteries under management agreements. Intercompany balances and transactions have been eliminated in consolidation

Income Taxes. Our historical financial statements include the effects of applicable U.S. federal and state income taxes in order to comply with GAAP. We are a limited partnership that has elected to be treated as a partnership for U.S. federal income tax purposes and therefore not be subject to U.S. federal or applicable state income taxes. See *Material Tax Considerations* included in our Registration Statement on Form S-3 (Registration No. 333-129916) filed with the SEC. In order to be treated as a partnership for federal income tax purposes, at least 90% of our gross income must be qualifying income, which includes income from the sale of real property, including burial lots (with and without installed vaults and grave marker bases), lawn and mausoleum crypts and cremation niches. Most of our activities that do not generate qualifying income, such as the sale of other cemetery products, the provision of perpetual care services, the operation of our managed cemeteries and all funeral home operations, will be owned by and conducted through these corporate subsidiaries, which will be subject to tax on their net taxable income. Dividends we receive from corporate subsidiaries will be qualifying income.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on the consolidated financial statements of Stonemor Partners L.P. We prepared these financial statements in conformity with GAAP. 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. We continue 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.

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, 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.

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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 that are 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.

Earnings from the perpetual care trusts are recognized, as earned, in cemetery revenues and are used to defray cemetery maintenance costs, which are expensed as incurred.

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. Because of 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 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 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.

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As of December 31, 2006 Stonemor Partners L.P., and its affiliated group of corporate subsidiaries had a consolidated federal net operating loss carryover of approximately \$40.9 million and state net operating losses of approximately \$74.2 million. The federal net operating losses will begin to expire in 2019 and the state net operating losses began to expire during 2006. These are available to reduce future taxable income of our taxable subsidiaries that would otherwise be subject to federal income taxes. 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. Although we do not anticipate that an ownership change will occur prior to December 31, 2008, we cannot assure you that such ownership change will not occur. If an ownership change should occur during this period, an increase in tax liabilities of our corporate subsidiaries could result, which would reduce the amount of cash available for distribution to unitholders. Furthermore, in order to avoid the consequences of an ownership change, we may refrain from making some acquisitions that we otherwise would finance at least in part with additional units or the proceeds of an offering of common units. As a result, we may be less able to implement our acquisition growth strategy during the next three years.

Results of Operations

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

| | Year Ended December 31, | | |
|--------------------------------------|-------------------------|-----------|------------|
| | 2004 | 2005 | 2006 |
| | (in thousands) | | |
| Statement of Operations Data: | | | |
| Revenues: | | | |
| Cemetery | \$ 87,305 | \$ 97,862 | \$ 108,995 |
| Funeral home | 1,953 | 2,798 | 6,118 |
| Total | 89,258 | 100,660 | 115,113 |
| Costs and Expenses: | | | |
| Cost of goods sold: | | | |
| Land and crypts | 4,539 | 5,860 | 5,287 |
| Perpetual care | 2,692 | 2,575 | 3,109 |
| Merchandise | 5,143 | 5,463 | 6,296 |
| Cemetery expense | 19,648 | 20,942 | 24,344 |
| Selling expense | 19,158 | 20,072 | 23,186 |
| General and administrative expense | 9,797 | 10,553 | 12,801 |
| Corporate overhead | 12,658 | 16,304 | 19,795 |
| Depreciation and amortization | 4,547 | 3,510 | 3,501 |
| Funeral home expense | 1,712 | 2,382 | 4,836 |
| Expenses related to refinancing | 4,200 | | |
| Interest expense | 9,480 | 6,457 | 7,491 |
| Income taxes (benefit) | (478) | 1,837 | 1,427 |
| Net (loss) income | \$ (3,838) | \$ 4,705 | \$ 3,040 |

Balance Sheet Data (as of period end):

| | | | |
|---------------------------------|------------|------------|------------|
| Deferred cemetery revenues, net | \$ 156,051 | \$ 167,035 | \$ 196,103 |
|---------------------------------|------------|------------|------------|

Year Ended December 31, 2006 versus Year Ended December 31, 2005

Cemetery Revenues. Cemetery revenues were \$109.0 million in 2006, an increase of \$11.1 million, or 11.3%, as compared to \$97.9 million in 2005. Cemetery revenues from pre-need sales, including interest income from pre-need installment contracts and investment income from trusts, were \$68.9 million in 2006, an increase of \$5.2 million, or 8.2%, as compared to \$63.7 million in 2005. The increase primarily resulted from increased

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lot sales (\$1.4 million), performance of additional initial opening and closings (\$2.8 million) and increased vault deliveries (\$2.4 million). An additional contribution to the increase in cemetery revenue from pre-need sales was higher accumulated earnings from merchandise trusts allocated to the pre-need products delivered during 2006. Total revenues from merchandise and perpetual care trust for 2006 were higher by \$1.4 million than 2005. The increase in the deliveries of pre-need products and services in 2006 was primarily as a result of the full year contribution of properties we acquired in 2005. These increases were offset by a decrease in casket deliveries of \$2.6 million, due to production problems of the Company's major casket supplier.

Cemetery revenues from at-need sales in 2006 were \$37.7 million, an increase of \$7.1 million, or 23.2%, as compared to \$30.6 million in 2005. The increase in cemetery revenues from at-need sales was primarily attributable to higher sales of all at need cemetery merchandise and services. Generally, these increases are related to the full year contribution of properties that we acquired in 2005.

Other cemetery revenues were \$2.2 million in 2006, a decrease of \$1.4 million, or 38.9%, from \$3.6 million in 2005. The decrease in other cemetery revenues was primarily attributable to a decrease in sales of undeveloped land of \$1.4 million.

Costs of Goods Sold. Cost of goods sold was \$14.7 million in 2006, an increase of \$0.8 million, or 5.8%, as compared to \$13.9 million in 2005. As a percentage of cemetery revenues, cost of goods decreased from 14.2% in the year ended December 31, 2005 to 13.5% for the year ended December 31, 2006. The decrease in cost of goods sold as a percentage of cemetery revenues is attributable to higher gross profit margin attained on the sale of interment rights (lots and mausoleums) and higher gross profit margins associated with the deliveries of markers and monument bases in 2006 than with the delivery of markers and monuments bases 2005.

Selling Expense. Total selling expense was \$23.2 million in 2006, an increase of \$3.1 million, or 15.4%, as compared to \$20.1 million 2005. Sales commissions and other compensation expenses contributed \$17.5 million to total selling expense during 2006, an increase of \$3.0 million, or 20.7%, compared to \$14.5 million in 2005. As a percentage of pre-need sales, sales commissions and other compensation expenses were 35.6% in 2006, as compared to 34.2% in 2005. This increase is primarily attributable to higher average commission rates and bonuses recognized related to a product mix. Indirect selling expenses were \$5.3 million during 2006, an increase of \$0.7 million, or 15.2%, compared to \$4.6 million in 2005. The increased cost was primarily attributed to an increase of \$0.3 million in advertising, an increase in telemarketing costs of \$0.1 and an increase in telephone charges of \$0.1 million.

Cemetery Expense. Cemetery expense was \$24.3 million in 2006, an increase of \$3.4 million, or 16.3%, as compared to \$20.9 million in the same period of 2005. This increase was primarily attributable to an increase in cemetery labor of \$1.9 million, increased cemetery maintenance and supplies of \$0.7 million, increased real estate taxes of \$0.2 million and increased building repair and maintenance costs of \$0.1 million. These increases relate to the full year expenses of properties that we acquired in 2005.

General and Administrative Expense. General and administrative expense was \$12.8 million in 2006, an increase of \$2.2 million, or 20.8%, as compared to \$10.6 million in the same period of 2005. The increase was primarily attributable to an increase in office labor expenses of \$1.2 million, an increase in insurance expenses of \$0.3 million and an increase in surety bond costs of \$0.4 million. These increases relate to the full year expenses of properties that we acquired in 2005.

Funeral Home Revenues and Expense. Funeral home revenues were \$6.1 million in 2006, an increase of approximately \$3.3 million, or 117.9%, as compared to \$2.8 million during the same period of 2005. Funeral home expense was approximately \$4.8 million in 2006, an increase \$2.4 million, or 100.0%, as compared to \$2.4 million during the same period of 2005. The increases in revenues and expenses relate to the addition of six funeral homes in November 2005 and 13 funeral homes in September of 2006.

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Corporate Overhead. Corporate overhead was \$19.8 million in 2006, an increase of \$3.5 million, or 21.5%, as compared to \$16.3 million in 2005. 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 program in November of 2006. We expect to incur similar non-cash expenses of approximately \$3.9 million in 2007, \$2.1 million in 2008 and \$1.0 million in 2009, related to the vesting of this grant in accordance with FAS123R. Additionally, we incurred \$2.0 million in increased salary due to our 2006 bonus program and \$0.9 million in reserves for the write-off of our investment in a management agreement that was terminated subsequent to year-end 2006. These increases were off set by a reduction in professional fees of \$0.2 million and a reduction of software expenses of \$0.4 million.

Depreciation and Amortization. Depreciation and amortization was \$3.5 million in 2006, essentially unchanged from 2005.

Interest Expense. Interest expense was \$7.5 million in 2006, an increase of \$1.0 million or 15.4%, as compared to \$6.5 million in 2005. The increase was primarily attributable to an increase in the average amount of debt outstanding during 2006.

Provision for Income Taxes. Provision for income taxes was \$1.4 million in 2006 as compared to \$1.8 million in 2005. The change in provision for income taxes was primarily due to lower revenues in our taxable subsidiaries in 2006 as compared to 2005.

Net Income/ Loss. Net income was \$3.0 million in 2006, a decrease of \$1.7 million, as compared to net income of \$4.7 million in 2005. The decrease is primarily due to approximately \$1.2 million non-cash compensation charge for our Long-Term Incentive Plan, a cash bonus payment of approximately \$2.0 million, and a reserve for the write-off of our investment in a management agreement at one of our locations that was terminated subsequent to year-end 2006 of \$0.9 million.

Deferred Cemetery Revenue. Deferred cemetery revenues, net, increased \$29.1 million, or 17.4%, in 2006, from \$167.0 million as of December 31, 2005 to \$196.1 million as of December 31, 2006. In 2005, deferred cemetery revenues, net, increased \$10.9 million, or 7.0%, from \$156.1 million as of December 31, 2004 to \$167.0 million as of December 31, 2005. The net increase in 2006 was primarily attributable to an increase in sales of pre-need cemetery products and services that were not delivered or performed in 2006. We added \$59.2 million in pre-need sales of cemetery merchandise and services, net of deferred costs and cancellations, to our pre-need sales backlog during 2006 as compared to \$43.8 million added during 2005. These increases were offset by revenues recognized, net of costs, of \$40.1 million, including accumulated merchandise trust earnings, during 2006 related to the delivery and performance of pre-need cemetery merchandise and services as compared to \$36.8 million of revenues recognized in 2005. The additional increase in deferred cemetery revenues, net relates to acquisitions completed in 2005 and 2006.

Year Ended December 31, 2005 versus Year Ended December 31, 2004

Cemetery Revenues. Cemetery revenues were \$97.9 million in 2005, an increase of \$10.6 million, or 12.1%, as compared to \$87.3 million in 2004. Cemetery revenues from pre-need sales, including interest income from pre-need installment contracts and investment income from trusts, were \$63.7 million in 2005, an increase of \$8.3 million, or 15.0%, as compared to \$55.4 million in 2004. The increase primarily resulted from increased mausoleum and crypt sales (\$2.7 million), increased casket deliveries (\$2.0 million), increased lot sales (\$1.4 million), performance of additional initial opening and closings (\$0.3 million) and increased vault deliveries (\$0.2 million). An additional contribution to the increase in cemetery revenue from pre-need sales was higher accumulated earnings from merchandise trusts allocated to the pre-need products delivered during 2005. Total revenues from merchandise and perpetual care trust for 2005 were higher by \$1.9 million than 2004. The increase in the deliveries of pre-need products and services in 2005 was a result of management's continuation of cash flow management initiatives initiated in 2003. These increases were offset by a decrease in interest income of \$0.5 million and decreased marker sales of \$0.5 million.

Cemetery revenues from at-need sales in 2005 were \$30.6 million, an increase of \$1.4 million, or 4.8%, as compared to \$29.2 million in 2004. The increase in cemetery revenues from at-need sales was primarily

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attributable to higher sales of monument bases and markers of \$0.6 million, higher sales of at-need interment rights of \$0.3 million, and higher sales of at-need lots of \$0.1 million.

Other cemetery revenues were \$3.6 million in 2005, an increase of \$0.9 million, or 33.3%, from \$2.7 million in 2004. The increase in other cemetery revenues was primarily attributable to an increase in sales of undeveloped land of \$1.4 million partially offset by other miscellaneous items.

Costs of Goods Sold. Cost of goods sold was \$13.9 million in 2005, an increase of \$1.5 million, or 12.1%, as compared to \$12.4 million in 2004. As a percentage of cemetery revenues, cost of goods sold was 14.2% in the year ended December 31, 2005 unchanged from 2004.

Selling Expense. Total selling expense was \$20.1 million in 2005, an increase of \$0.9 million, or 4.7%, as compared to \$19.2 million 2004. Sales commissions and other compensation expenses contributed \$14.5 million to total selling expense during 2005, an increase of \$1.0 million, or 7.4%, compared to \$13.5 million in 2004. As a percentage of pre-need sales, sales commissions and other compensation expenses were 32.4% in 2005, as compared to 34.7% in 2004. This decrease is primarily attributable to lower average commission rates and bonuses recognized related to a product mix. Indirect selling expenses were \$5.3 million during 2005, a decrease of \$0.3 million, or 5.4%, compared to \$5.6 million in 2004. The decreased cost was primarily attributed to a decrease of \$0.6 million in employee benefits partially offset by an increase in advertising of \$0.2 million.

Cemetery Expense. Cemetery expense was \$20.9 million in 2005, an increase of \$1.3 million, or 6.6%, as compared to \$19.6 million in the same period of 2004. This increase was primarily attributable to an increase in cemetery labor of \$0.2 million, increased utility costs of \$0.2 million, increased real estate taxes of \$0.2 million and increased building repair and maintenance costs of \$0.1 million. These increases relate to our increased focus on cash flow maximization, which we accomplish by accelerating the performance of some of our pre-need services and increasing the delivery of pre-need merchandise.

General and Administrative Expense. General and administrative expense was \$10.6 million in 2005, an increase of \$0.8 million, or 8.2%, as compared to \$9.8 million in the same period of 2004. The increase was primarily attributable to an increase in professional fees of \$0.5 million,.

Funeral Home Revenues and Expense. Funeral home revenues were \$2.8 million in 2005, an increase of approximately \$0.9 million, or 47.4%, as compared to \$1.9 million during the same period of 2004. Funeral home expense was approximately \$2.4 million in 2005, an increase \$0.7 million, or 41.2%, as compared to \$1.7 million during the same period of 2004. The increases in revenues and expenses relate to the addition of six funeral homes in November 2005.

Corporate Overhead. Corporate overhead was \$16.3 million in 2005, an increase of \$3.6 million, or 28.3%, as compared to \$12.7 million in 2004. The increase was primarily attributable to \$2.1 million in additional expenses related to first year Sarbanes-Oxley compliance and other incremental costs related to being a public entity for all of 2005.

Depreciation and Amortization. Depreciation and amortization was \$3.5 million in 2005, a decrease of \$1.0 million, or 22.2%, as compared to \$4.5 million in 2004. The decrease was primarily related to the amortization expense of debt issuance costs recognized in 2004 and not similarly recognized in 2005.

Expenses related to refinancing. We had no expenses related to refinancing in 2005. Of the \$4.2 million of expenses related to refinancing in 2004, \$3.9 million were attributable to the write-off of debt issuance costs related to our former credit facility and \$0.3 million were related to a fee paid for early extinguishment of debt.

Interest Expense. Interest expense was \$6.5 million in 2005, a decrease of \$3.0 million or 31.6%, as compared to \$9.5 million in 2004. The decrease was primarily attributable to a decrease in the average amount of debt outstanding during 2005. We used a portion of the proceeds of our initial public offering in September 2004 to reduce the amount of outstanding debt.

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Provision (Benefit) for Income Taxes. Provision for income taxes was \$1.8 million in 2005 as compared to a benefit for income taxes that was \$0.5 million in 2004. The change in provision (benefit) for income taxes was primarily due to an increase in the net amount of trust withdrawals and increased taxable land sales in 2005 as compared to 2004. Additionally, in 2004, we benefited from a reduction in deferred taxes related to the change in tax status from a corporation to a partnership.

Net Income/ Loss. Net income was \$4.7 million in 2005, an increase of \$8.5 million, as compared to a net loss of \$3.8 million in 2004. The increase in net income was primarily attributable to our increase in operating profit and decrease in costs related to refinancing.

Deferred Cemetery Revenue. Deferred cemetery revenues, net, increased \$10.9 million, or 7.0%, in 2005, from \$156.1 million as of December 31, 2004 to \$167.0 million as of December 31, 2005. In 2004, deferred cemetery revenues, net, increased \$15.3 million, or 10.9%, from \$140.8 million as of December 31, 2003 to \$156.1 million as of December 31, 2004. The net increase in 2005 was primarily attributable to an increase in sales of pre-need cemetery products and services that were not delivered or performed in 2005. We added \$43.8 million in pre-need sales of cemetery merchandise and services, net of deferred costs and cancellations, to our pre-need sales backlog during 2005 as compared to \$43.3 million added during 2004. These increases were offset by revenues recognized, net of costs, of \$36.8 million, including accumulated merchandise trust earnings, during 2005 related to the delivery and performance of pre-need cemetery merchandise and services as compared to \$33.0 million of revenues recognized in 2004.

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 will be cash flow from operations and income from perpetual care trusts. Our primary source of funds for long-term liquidity needs will be 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 \$2.0 million for the construction of mausoleums. Additionally, we anticipate ongoing annual capital expenditure requirements of between approximately \$2.3 million and \$2.6 million for the foreseeable future. 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 Limited Partner units, 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 30, 2006 we completed the acquisition of 21 cemeteries and 14 funeral homes from Service Corporation International (NYSE: SCI) for \$11.8 million. We paid \$5.9 million in cash and 275,046 in Limited Partner units, 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.

We anticipate financing future acquisitions with the proceeds of borrowings under our credit facility or the issuance of additional common units and other partnership securities, including debt, to the extent permitted

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under our credit facility, the senior secured notes and our partnership agreement. Since our predecessor began operations in 1999, we have acquired fifty four cemetery properties ranging in price per cemetery from \$0.2 million to \$15.8 million and having an aggregate purchase price of \$57.5 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 from operating activities were \$18.3 million in 2006, an increase of \$0.7 million or 4.0%, as compared to cash flows from operating activities of \$17.6 million in 2005. The increase in cash flow was primarily attributable to an increase in cash collected on our accounts receivable of approximately \$8.8 million during 2006, a \$4.7 million net increase in cemetery revenue deferral, offset by a \$14.0 million increase in net trust deposits to our trust funds. Cash flows from operating activities were \$17.6 million in 2005, an increase of \$10.1 million or 135%, as compared to cash flows from operating activities of \$7.5 million in 2004. The increase in cash flow was primarily attributable to an increase in net income of approximately \$8.5 million during 2005 and increases in cash withdrawn from merchandise trusts of \$11.8 million, partially offset by an \$6.9 million net decrease in cemetery revenue deferral and a \$3.9 million decrease in non-cash charges related to refinancing in 2004.

Cash Flow from Investing Activities. Net cash used in investing activities was \$14.6 million during 2006, a decrease of \$0.7 million, as compared to \$15.3 million during 2005. This decrease was primarily attributable to the divestiture of one of our funeral homes partially offset by increased cemetery acquisition activity. Net cash used in investing activities was \$15.3 million during 2005, an increase of \$9.4 million, as compared to \$5.9 million during 2004. This increase was primarily attributable to the November 1, 2005 acquisition of 22 cemetery and six funeral home locations including due diligence costs of \$15.6 million.

Cash Flow from Financing Activities. Net cash used in financing activities during 2006 was \$0.7 million, a decrease of \$9.2 million from the net cash used in financing activities of \$9.8 million during 2005. The decrease from 2005 is primarily related to additional borrowings under our lines of credit which we used to finance our acquisitions and provide additional working capital. Cash used in financing activities during 2005 primarily relate to unitholder distributions of \$16.4 million offset by long-term debt borrowings of \$8.0 million. The 2004 cash flow from financing activities was primarily attributable to the results of our initial public offering and the sale of senior secured notes in a private placement. The net proceeds of \$58.0 million from the sale of limited partner units in our initial public offering together with the net proceeds from our offering of \$80.0 million aggregate principal amount of senior secured notes were used in part to repay the outstanding amounts on the term loan, revolving line of credit, a note to a seller of one of our acquisitions, and financing costs associated with issuing our senior secured notes and obtaining our credit facility.

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

| | Years Ended December 31, | | |
|----------------------------------|--------------------------|-----------|-----------|
| | 2004 | 2005 | 2006 |
| | (In Thousands) | | |
| Maintenance capital expenditures | \$ 2,620 | \$ 2,192 | \$ 2,059 |
| Expansion capital expenditures | 3,267 | 18,994 | 20,532 |
| Total capital expenditures | \$ 5,887 | \$ 21,186 | \$ 22,591 |

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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.

Contractual Obligations and Contingencies. A summary of our total contractual obligations including interest, as of December 31, 2006, is as follows (dollars in thousands):

| Type of Obligation | Total | Payment due by period | | | |
|---------------------------|------------|-----------------------|----------------|----------------|----------------------|
| | | Less than 1 year | 1 - 3 years | 3 - 5 years | More than 5 years |
| Long-term debt (1) | \$ 135,036 | \$ 9,303 | \$ 14,897 | \$ 110,836 | \$ |
| Operating leases | 3,415 | 595 | 1,121 | 823 | 876 |
| Merchandise liability (2) | 45,805 | | | | |
| Total | \$ 184,256 | \$ 9,898 | \$ 16,018 | \$ 111,659 | \$ 876 |

(1) Represents obligations including interest under the senior secured notes as described below.

(2) Total cannot be separated into periods because we are unable to anticipate when the merchandise will be needed. We will satisfy these obligations at or, to the extent practicable, prior to the time of need.

Credit Facility. On September 20, 2004, we paid in full all amounts outstanding under our old credit facility, which consisted of \$25.5 million under our revolving credit facility and a \$103.1 million term loan, from a portion of the net proceeds of our initial public offering and the private placement of senior secured notes. The term loan and borrowings under the old revolving credit facility bore interest at 18.0% per annum beginning September 15, 2004, and would have increased an additional 2.0% per annum on each of January 1, 2005 and April 1, 2005. Prior to September 15, 2004, the term loan and borrowings under the old revolving credit facility bore interest at the aggregate rate of 4.5% plus the greater of LIBOR or 3.5%.

Concurrent with the closing of our initial public offering on September 20, 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 are due and payable three years after the date of the credit agreement, and borrowings under the acquisition facility are due and payable four years after the date of the credit agreement. 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 December 31, 2006, we had \$22.95 million outstanding under our credit agreement.

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.

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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 will be 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 second 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 and 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 secondary priority lien and security interest in those specified receivable rights of the borrowers and the guarantors. The senior secured notes 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.

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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 EBITDA, 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 EBITDA of not more than 3.5 to 1.0 for the four most recent quarters; 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 reverts back to 3.5 to 1. On March 31, 2006 we requested a waiver of any default arising from our failure to meet the requirement that requires us to deliver the 2005 annual audited financial statements within 95 days of the 2005 fiscal year-end. Our lenders agreed to this waiver provided that we deliver the 2005 annual audited financial statements within 125 days of 2005 fiscal year-end, which we did. As of March 15, 2007, we are 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

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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 and a second priority lien and security interest covering those specified receivable rights, each as described above, of the issuers, whether then owned or thereafter acquired.

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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, having commenced 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; and

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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.

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;

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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.

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.

Off-Balance Sheet Arrangements. As of December 31, 2006, we had no off-balance sheet arrangements except for operating leases

Inflation. Inflation in the United States has been relatively low in recent years and did not have a material impact on our results of operations during 2004, 2005 or 2006. Although the impact of inflation has been insignificant in recent years, it is still a factor in the U.S. economy and may increase the cost to acquire or replace property, plant and equipment and may increase the costs of labor and supplies. To the extent permitted by competition and regulation, we have and will continue to pass along increased costs to our customers in the form of higher product prices.

Recent Accounting Pronouncements.

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, and will be adopted by the Company on January 1, 2007. The Company currently does not believe that the adoption of Interpretation 48 will have a significant effect on its 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

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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 for us. 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. See Note 2 to the consolidated financial statements.

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.

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Part IV

Item 15. Exhibits and Financial Statement Schedules

(a) Financial Statements and Financial Schedules

(1) The following financial statements of StoneMor Partners L.P. and its predecessor Cornerstone Family Services, Inc. were included in Part II, Item 8 of the Original 10-K:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2005 and 2006

Consolidated Statement of Operations for the years ended December 31, 2004, 2005 and 2006

Consolidated Statement of Common Stockholders / Partners Equity for the years ended December 31, 2005 and 2006

Consolidated Statement of Cash Flows for the years ended December 31, 2004, 2005, and 2006

Notes to the Consolidated Financial Statements

(c) Exhibits

- 3.1* Certificate of Limited Partnership of StoneMor Partners L.P. (incorporated by reference to the Registration Statement on Form S-1 filed with the Securities and Exchange Commission on April 9, 2004 (Exhibit 3.1)).
- 3.2* First Amended and Restated Agreement of Limited Partnership of StoneMor Partners L.P., dated as of September 20, 2004 (incorporated by reference to Exhibit 3.2 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)
- 4.1* Note Purchase Agreement by and among StoneMor GP LLC, StoneMor Partners L.P., StoneMor Operating LLC, each of the subsidiaries listed on the signature pages thereof and SFT I, Inc., The Prudential Insurance Company of America and Prudential Retirement Insurance and Annuity Company, dated as of September 20, 2004 (incorporated by reference to Exhibit 4.1 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)
- 4.1.1* First Amendment to Note Purchase Agreement by and among StoneMor GP LLC, StoneMor Partners L.P., StoneMor Operating LLC, each of the subsidiaries listed on the signature pages thereof and SFT I, Inc., The Prudential Insurance Company of America and Prudential Retirement Insurance and Annuity Company, dated as of November 12, 2004 (incorporated by reference to Exhibit 4.1.1 of Registrant's Annual Report on Form 10-K for its year ended December 31, 2004)
- 10.1* Credit Agreement by and among StoneMor Operating LLC, StoneMor GP LLC, StoneMor Partners L.P., various additional borrowers, various lending institutions and Fleet National Bank, dated September 20, 2004. (incorporated by reference to Exhibit 10.1 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)
- 10.2* Contribution, Conveyance and Assumption Agreement, by and among StoneMor Partners L.P., StoneMor GP LLC, CFSI LLC, StoneMor Operating LLC, dated as of September 20, 2004 (incorporated by reference to Exhibit 10.2 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)
- 10.3* StoneMor Partners L.P. Long-Term Incentive Plan (incorporated by reference to Exhibit 10.3 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)

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10.4* Omnibus Agreement by and among McCown De Leeuw & Co. IV, L.P., McCown De Leeuw & Co. IV Associates, L.P., MDC Management Company IV, LLC, Delta Fund LLC, Cornerstone Family Services LLC, CFSI LLC, StoneMor Partners L.P., StoneMor GP LLC, StoneMor Operating LLC, dated as of September 20, 2004 (incorporated by reference to Exhibit 10.4 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)

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10.5* Employment Agreement by and between StoneMor GP LLC and Lawrence Miller, effective as of September 20, (incorporated by reference to Exhibit 10.2 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)

10.6* Employment Agreement by and between StoneMor GP LLC and William R. Shane, effective as of September 20, 2004 (incorporated by reference to Exhibit 10.6 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)

10.7* Employment Agreement by and between StoneMor GP LLC and Michael L. Stache, effective as of September 20, 2004 (incorporated by reference to Exhibit 10.7 of Registrants Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)

10.8* Employment Agreement by and between StoneMor GP LLC and Robert Stache, effective as of September 20, 2004 (incorporated by reference to Exhibit 10.8 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)

10.9* Form of Indemnification Agreement by and between StoneMor GP LLC and Lawrence Miller, Robert B. Hellman, Jr., Fenton R. Talbott, Jeffery A. Zawadsky, Martin R. Lautman, William R. Shane, Allen R. Freedman, effective September 20, 2004 (incorporated by reference to Exhibit 10.9 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)

10.10* Intercreditor and Collateral Agency Agreement by and among StoneMor GP LLC, StoneMor Partners L.P., StoneMor Operating LLC, various subsidiaries, various lenders and noteholders and Fleet National Bank, dated September 20, 2004 (incorporated by reference to Exhibit 10.10 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004)

10.11* Directors compensation (incorporated by reference to Item 1.01 of Registrant's Current Report on Form 8-K filed on August 9, 2005)

10.12* Amendment to StoneMor Partners L.P. Long-Term Incentive Plan (incorporated by reference to Item 8.01 of Registrant's Current Report on Form 8-K filed on November 18, 2005)

10.13* Asset purchase and Sale Agreement by and between StoneMor Partners L.P. and SCI Funeral Services, Inc., an Iowa corporation (SCI) and a wholly-owned subsidiary of Service Corporation International, a Texas corporation, joined by certain of SCI's direct and indirect subsidiary entities, effective October 13, 2005 (incorporated by reference to Item 1.01 of Registrant's Current Report on Form 8-K filed on October 13, 2005)

10.14* Registration Rights Agreement by and between StoneMor Partners L.P. and SCI Funeral Services, Inc., an Iowa corporation (SCI) and a wholly-owned subsidiary of Service Corporation International, a Texas corporation, joined by certain of SCI's direct and indirect subsidiary entities, effective November 1, 2005 (incorporated by reference to Item 1.01 of Registrant's Current Report on Form 8-K filed on November 2, 2005)

21.1** Subsidiaries of Registrant

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

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

* Incorporated by reference, as indicated
Management contract, compensatory plan or arrangement

** Previously filed

*** Previously furnished.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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

December 13, 2007

By: /s/ LAWRENCE MILLER
Lawrence Miller
Chief Executive Officer, President and
Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signatures | Title | Date |
|---|--|-------------------|
| /s/ LAWRENCE MILLER Lawrence Miller (Principal Executive Officer) | Chief Executive Officer, President and Chairman of the Board | December 13, 2007 |
| /s/ WILLIAM R. SHANE William R. Shane (Principal Financial Officer) | Executive Vice President, Chief Financial Officer and Director | December 13, 2007 |
| /s/ PAUL WAIMBERG Paul Waimberg (Principal Accounting Officer) | Vice President Finance | December 13, 2007 |
| /s/ ALLEN R. FREEDMAN | Director | December 13, 2007 |
| /s/ PETER K. GRUNEBaum | Director | December 13, 2007 |
| /s/ ROBERT B. HELLMAN, JR. Robert B. Hellman, Jr. | Director | December 13, 2007 |
| /s/ MARTIN R. LAUTMAN, PH.D. | Director | December 13, 2007 |

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Martin R. Lautman, Ph.D.

/s/ FENTON R. TALBOTT

Director

December 13, 2007

/s/ HOWARD L. CARVER

Director

December 13, 2007

Howard L. Carver

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| Exhibit Number | Description |
|-----------------------|---|
| 3.1* | Certificate of Limited Partnership of StoneMor Partners L.P. (incorporated by reference to the Registration Statement on Form S-1 filed with the Securities and Exchange Commission on April 9, 2004 (Exhibit 3.1)). |
| 3.2* | First Amended and Restated Agreement of Limited Partnership of StoneMor Partners L.P., dated as of September 20, 2004 (incorporated by reference to Exhibit 3.2 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004). |
| 3.2.1* | Amendment No. 1 to First Amended and Restated Agreement of Limited Partnership of StoneMor Partners L.P., effective as of February 27, 2007 (incorporated by reference to Exhibit 3.3 of Registrant's Current Report on Form 8-K filed on February 28, 2007). |
| 4.1* | Note Purchase Agreement by and among StoneMor GP LLC, StoneMor Partners L.P., StoneMor Operating LLC, each of the subsidiaries listed on the signature pages thereof and SFT I, Inc., The Prudential Insurance Company of America and Prudential Retirement Insurance and Annuity Company, dated as of September 20, 2004 (incorporated by reference to Exhibit 4.1 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004). |
| 4.1.1* | First Amendment to Note Purchase Agreement by and among StoneMor GP LLC, StoneMor Partners L.P., StoneMor Operating LLC, each of the subsidiaries listed on the signature pages thereof and SFT I, Inc., The Prudential Insurance Company of America and Prudential Retirement Insurance and Annuity Company, dated as of November 12, 2004 (incorporated by reference to Exhibit 4.1.1 of Registrant's Annual Report on Form 10-K for its year ended December 31, 2004). |
| 4.2* | Registration Rights Agreement by and between StoneMor Partners L.P. and SCI Funeral Services, Inc., an Iowa corporation (SCI) and a wholly-owned subsidiary of Service Corporation International, a Texas corporation, joined by certain of SCI's direct and indirect subsidiary entities, effective November 1, 2005 (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on November 2, 2005). |
| 4.3* | Registration Rights Agreement, dated as of September 28, 2006, by and between StoneMor Partners L.P. acting by its General Partner, StoneMor GP LLC, and SCI New Mexico Funeral Services, Inc. (incorporated by reference to Exhibit 10.4 to Registrant's Current Report on Form 8-K filed on October 4, 2006). |
| 10.1* | Credit Agreement by and among StoneMor Operating LLC, StoneMor GP LLC, StoneMor Partners L.P., various additional borrowers, various lending institutions and Fleet National Bank, dated September 20, 2004 (Incorporated by reference to Exhibit 10.1 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004.) |
| 10.1.1* | Second Amendment to Credit Agreement, dated September 28, 2006, by and among StoneMor GP LLC, StoneMor Partners L.P., StoneMor Operating LLC and its subsidiaries set forth on the signature page to the Second Amendment to the Credit Agreement, the Lenders party to the Second 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 (incorporated by reference to Exhibit 10.5 to Registrant's Current Report on Form 8-K filed on October 4, 2006). |
| 10.2* | Contribution, Conveyance and Assumption Agreement, by and among StoneMor Partners L.P., StoneMor GP LLC, CFSI LLC, StoneMor Operating LLC, dated as of September 20, 2004 (incorporated by reference to Exhibit 10.2 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004) |
| 10.3* | StoneMor Partners L.P. Long-Term Incentive Plan (incorporated by reference to Exhibit 10.3 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004) |

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| Exhibit Number | Description |
|-----------------------|---|
| 10.3.1* | Amendment to StoneMor Partners L.P. Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on November 18, 2005) |
| 10.3.2* | Long-Term Incentive Plan, as amended on November 8, 2006 (incorporated by reference to Exhibit 10.3 of Registrant's Current Report on Form 8-K filed on November 15, 2006). |
| 10.3.3* | Form of the Director Restricted Phantom Unit Agreement Under the StoneMor Partners L.P. Long-Term Incentive Plan, dated November 8, 2006 (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on November 15, 2006). |
| 10.3.4* | Form of the Key Employee Restricted Phantom Unit Agreement Under the StoneMor Partners L.P. Long-Term Incentive Plan, dated November 8, 2006 (incorporated by reference to Exhibit 10.2 of Registrant's Current Report on Form 8-K filed on November 15, 2006). |
| 10.3.5* | Form of the Unit Appreciation Rights Agreement Under the StoneMor Partners L.P. Long-Term Incentive Plan, dated as of November 27, 2006 (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on December 1, 2006). |
| 10.4* | Omnibus Agreement by and among McCown De Leeuw & Co. IV, L.P., McCown De Leeuw & Co. IV Associates, L.P., MDC Management Company IV, LLC, Delta Fund LLC, Cornerstone Family Services LLC, CFSI LLC, StoneMor Partners L.P., StoneMor GP LLC, StoneMor Operating LLC, dated as of September 20, 2004 (incorporated by reference to Exhibit 10.4 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004). |
| 10.5* | Employment Agreement by and between StoneMor GP LLC and Lawrence Miller, effective as of September 20, 2004 (incorporated by reference to Exhibit 10.2 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004). |
| 10.6* | Employment Agreement by and between StoneMor GP LLC and William R. Shane, effective as of September 20, 2004 (incorporated by reference to Exhibit 10.6 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004). |
| 10.7* | Employment Agreement by and between StoneMor GP LLC and Michael L. Stache, effective as of September 20, 2004 (incorporated by reference to Exhibit 10.7 of Registrants Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004). |
| 10.8* | Employment Agreement by and between StoneMor GP LLC and Robert Stache, effective as of September 20, 2004 (incorporated by reference to Exhibit 10.8 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004). |
| 10.9* | Form of Indemnification Agreement by and between StoneMor GP LLC and Lawrence Miller, Robert B. Hellman, Jr., Fenton R. Talbott, Jeffery A. Zawadsky, Martin R. Lautman, William R. Shane, Allen R. Freedman, effective September 20, 2004 (incorporated by reference to Exhibit 10.9 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004). |
| 10.10* | Intercreditor and Collateral Agency Agreement by and among StoneMor GP LLC, StoneMor Partners L.P., StoneMor Operating LLC, various subsidiaries, various lenders and noteholders and Fleet National Bank, dated September 20, 2004 (incorporated by reference to Exhibit 10.10 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended September 30, 2004). |
| 10.11* | Directors compensation (incorporated by reference to Item 1.01 of Registrant's Current Report on Form 8-K filed on August 9, 2005). |
| 10.12* | Asset purchase and Sale Agreement by and between StoneMor Partners L.P. and SCI Funeral Services, Inc., an Iowa corporation (SCI) and a wholly-owned subsidiary of Service Corporation International, a Texas corporation, joined by certain of SCI's direct and indirect subsidiary entities, effective October 13, 2005 (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on October 17, 2005). |

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| Exhibit Number | Description |
|-----------------------|---|
| 10.13* | Asset Purchase and Sale Agreement, dated September 28, 2006, by and among StoneMor Operating LLC, joined by its direct and indirect subsidiary entities listed in Exhibit A to the Asset Purchase and Sale Agreement, and SCI Funeral Services, Inc., joined by its direct and indirect subsidiary entities listed in Exhibit B to the Asset Purchase and Sale Agreement (incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K filed on October 4, 2006). |
| 10.14* | Asset Purchase and Sale Agreement, dated September 28, 2006, by and among StoneMor Operating LLC, joined by StoneMor Michigan LLC and StoneMor Michigan Subsidiary LLC, and SCI Funeral Services, Inc., SCI Michigan Funeral Services, Inc. and Hawes, Inc. (incorporated by reference to Exhibit 10.2 to Registrant's Current Report on Form 8-K filed on October 4, 2006). |
| 10.15* | Asset Purchase and Sale Agreement, dated September 28, 2006, by and among StoneMor Operating LLC, joined by StoneMor Michigan LLC and StoneMor Michigan Subsidiary LLC, and SCI Funeral Services, Inc., and SCI Michigan Funeral Services, Inc. and Hillcrest Memorial Company (incorporated by reference to Exhibit 10.3 to Registrant's Current Report on Form 8-K filed on October 4, 2006). |
| 21.1** | Subsidiaries of Registrant. |
| 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). |

* Incorporated by reference, as indicated
Management contract, compensatory plan or arrangement
** Previously filed
*** Previously furnished.