

STONEMOR PARTNERS LP  
Form 10-Q/A  
May 15, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q/A**

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(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE QUARTERLY PERIOD ENDED March 31, 2005

OR

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

Commission File Number: 000-50910

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**STONEMOR PARTNERS L.P.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**155 Rittenhouse Circle**

**Bristol, Pennsylvania**

**80-0103159**  
(I.R.S. Employer

Identification No.)

**19007**

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(Address of principal executive offices)

(215) 826-2800

(Zip Code)

(Registrant's telephone number, including area code)

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

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

The number of the registrant's outstanding common units at May 13, 2005 was 4,239,782.

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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A to our quarterly report on Form 10-Q for the quarter ended March 31, 2005 ( Original Filing ), initially filed with the Securities and Exchange Commission ( SEC ) on May 16, 2005, is being filed to reflect restatements of our condensed consolidated financial statements of and for the three months ended March 31, 2005. For a more detailed description of these restatements, see Note 2, Restatement of Financial Statements to the accompanying condensed consolidated financial statements.

The restatement has no effect on the Company's net cash flows or distributions to its unitholders. Following an internal and external audit of our cemetery locations, we determined that some of the pre-need burial vaults that we previously believed to have been installed in to the ground during 2005, had not been installed. We install burial vaults in advance of need in order to provide for a secure storage location and expedite the at-need interment process. In accordance with SAB 104, we recognize revenue related to the pre-need sale of burial vaults when we install them into the ground. As such, the erroneous indication that these vaults had been installed caused us to recognize revenue in advance of the revenue recognition triggering event.

In addition, the Company determined that Deferred Selling and Obtaining Costs related to its pre-need sales should be classified as an asset of the Company instead of as a reduction of Deferred Revenues, net.

For the convenience of the reader, this Form 10-Q/A includes the Original Filing in its entirety as amended by this Form 10-Q/A. However, this Form 10-Q/A only amends and restates Items 1, 2 and 4 of Part I of the Original Filing and no other material information in the Original Filing is amended hereby. The foregoing items have not been updated to reflect other events concerning our business or financial condition occurring after the Original Filing or to modify or update those disclosures affected by subsequent events. In addition, pursuant to the rules of the SEC, Item 6 of Part II of the Original Filing has been amended to contain currently-dated certifications from our Chief Executive Officer and Chief Financial Officer, as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. The certifications of our Chief Executive Officer and Chief Financial Officer are attached to this Form 10-Q/A as Exhibits 31.1, 31.2, 32.1 and 32.

Except for the foregoing amended information, this Form 10-Q/A continues to describe conditions as of the date of the Original Filing, and the disclosures contained herein have not been updated to reflect events, results or developments that occurred at a later date. Among other things, forward looking statements made in the Original Filing 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 Filing (other than the restatement), and such forward looking statements should be read in their historical context.

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**Table of Contents****Part I Financial Information****Item 1. Financial Statements****StoneMor Partners L.P.****Successor to Cornerstone Family Services, Inc. (Predecessor)****Condensed Consolidated Balance Sheets**

(in thousands)

(unaudited)

	<b>December 31,</b>	<b>March 31,</b>
	<b>2004</b>	<b>2005</b>
	<b>(as restated see</b>	<b>(as restated see</b>
	<b>Note 2)</b>	<b>Note 2)</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 14,474	\$ 12,405
Accounts receivable, net of allowance	25,479	25,673
Prepaid expenses	1,778	2,617
Other current assets	861	1,036
<b>Total current assets</b>	<b>42,592</b>	<b>41,731</b>
LONG-TERM ACCOUNTS RECEIVABLE - net of allowance	32,402	31,378
CEMETERY PROPERTY	150,215	149,606
PROPERTY AND EQUIPMENT - NET	22,616	22,724
MERCHANDISE TRUSTS, restricted, at fair value	114,798	109,981
PERPETUAL CARE TRUSTS, restricted, at fair value	127,949	126,501
DEFERRED FINANCING COSTS - net of accumulated amortization	2,551	2,376
DEFERRED SELLING AND OBTAINING COSTS	28,625	29,161
OTHER ASSETS	1,344	1,350
<b>TOTAL ASSETS</b>	<b>\$ 523,092</b>	<b>\$ 514,808</b>
<b>LIABILITIES AND PARTNERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable and accrued liabilities	\$ 6,136	\$ 4,252
Accrued interest	162	162
<b>Total current liabilities</b>	<b>6,298</b>	<b>4,414</b>
LONG-TERM DEBT	80,000	80,000
DEFERRED CEMETERY REVENUES, net	156,051	156,458
MERCHANDISE LIABILITY	37,477	35,888
<b>TOTAL LIABILITIES</b>	<b>279,826</b>	<b>276,760</b>
<b>COMMITMENTS AND CONTINGENCIES</b>		

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NON-CONTROLLING INTEREST IN PERPETUAL CARE TRUSTS	127,949	126,501
PARTNERS' EQUITY		
General partner	1,663	1,587
Limited partners:		
Common	72,892	71,044
Subordinated	40,762	38,915
Total partners' equity	115,317	111,547
TOTAL LIABILITIES AND PARTNERS' EQUITY	\$ 523,092	\$ 514,808

See Accompanying Notes to the Condensed Consolidated Financial Statements.

**Table of Contents****StoneMor Partners L.P.****Successor to Cornerstone Family Services, Inc. (Predecessor)****Condensed Consolidated Statement of Operations**

(in thousands, except unit data)

(unaudited)

	<b>Cornerstone</b>	
	<b>Family</b>	<b>StoneMor</b>
	<b>Services, Inc.</b>	<b>Partners L.P.</b>
	<b>Three months ended March 31,</b>	<b>Three months ended March 31,</b>
	<b>2004</b>	<b>2005</b>
		<b>(as restated see</b>
		<b>Note 2)</b>
<b>Revenues:</b>		
Cemetery	\$ 17,969	\$ 20,345
Funeral home	499	621
Total revenues	18,468	20,966
<b>Costs and Expenses:</b>		
Cost of goods sold (exclusive of depreciation shown separately below):		
Land and crypts	828	963
Perpetual care	633	615
Merchandise	763	1,279
Cemetery expense	4,673	4,717
Selling expense	3,855	4,191
General and administrative expense	2,483	2,378
Corporate overhead	2,435	3,075
Depreciation and amortization	1,265	845
Funeral home expense	432	434
Total cost and expenses	17,367	18,497
<b>OPERATING PROFIT</b>	<b>1,101</b>	<b>2,469</b>
<b>INTEREST EXPENSE</b>	<b>2,532</b>	<b>1,581</b>
<b>INCOME / (LOSS) BEFORE INCOME TAXES</b>	<b>(1,431)</b>	<b>888</b>
<b>INCOME TAXES (BENEFIT):</b>		
State and franchise taxes	312	40
Federal	(355)	180
Total income taxes (benefit)	(43)	220
<b>NET INCOME (LOSS)</b>	<b>(1,388)</b>	<b>668</b>

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Net income per limited partner unit for the three months ended March 31, 2005:

Net income	\$	668
General partner's interest in net income for the period	\$	13
Limited partners' interest in net income for the period		
Common	\$	327
Subordinated	\$	327
Net income per limited partner (common) unit (basic and diluted)	\$	.08
Weighted average number of limited partners' units outstanding (basic and diluted)		8,480

See Accompanying Notes to the Condensed Consolidated Financial Statements.



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**StoneMor Partners L.P.**

**Successor to Cornerstone Family Services, Inc. (Predecessor)**

**Condensed Consolidated Statement of**

**Partners Equity**

(in thousands)

(unaudited)

	Partners Capital			General	
	Common	Subordinated	Total	Partner	Total
Balance, December 31, 2004	\$ 72,892	\$ 40,762	\$ 113,654	\$ 1,663	\$ 115,317
Net Income (as restated see Note 2)	326	327	653	14	668
Cash distribution	(2,174)	(2,174)	(4,348)	(90)	(4,438)
Balance, March 31, 2005 (as restated, see Note 2)	\$ 71,044	\$ 38,915	\$ 109,959	\$ 1,587	111,547

See Accompanying Notes to the Condensed Consolidated Financial Statements.

**Table of Contents****StoneMor Partners L.P.****Successor to Cornerstone Family Services, Inc. (Predecessor)****Condensed Consolidated Statement of Cash Flows**

(in thousands)

(unaudited)

	<b>Three months ended March 31, 2004</b>	<b>2005 (as restated see Note 2)</b>
<b>OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ (1,388)	\$ 668
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activity:		
Cost of lots sold	1,085	802
Depreciation and amortization	1,265	845
Deferred income tax (benefit)	(163)	
Changes in assets and liabilities that provided (used) cash:		
Accounts receivable	(288)	830
Merchandise trust fund	(3,299)	1,958
Prepaid expenses	8	(839)
Other current assets	192	(175)
Other assets	(804)	(4)
Accounts payable and accrued and other liabilities	(110)	(1,884)
Deferred cemetery revenue and deferred selling and obtaining costs	4,196	2,730
Merchandise liability	(744)	(1,589)
Net cash provided by operating activities	(50)	3,342
<b>INVESTING ACTIVITIES:</b>		
Additions to cemetery property	(230)	(227)
Acquisitions of property and equipment	(272)	(746)
Net cash used in investing activities	(502)	(973)
<b>FINANCING ACTIVITIES:</b>		
Cash distribution		(4,438)
Additional borrowings on long-term debt	1,998	
Repayments of long-term debt	(1,396)	
Net cash provided by (used in) financing activities	602	(4,438)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>50</b>	<b>(2,069)</b>
<b>CASH AND CASH EQUIVALENTS - Beginning of period</b>	<b>5,554</b>	<b>14,474</b>
<b>CASH AND CASH EQUIVALENTS - End of period</b>	<b>\$ 5,604</b>	<b>\$ 12,405</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid during the period for interest	\$ 2,468	\$ 1,576

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Cash paid during the period for income taxes	\$	15	\$	671
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See Accompanying Notes to the Condensed Consolidated Financial Statements.

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

**Basis of Presentation.** On April 2, 2004, StoneMor Partners L.P. ( StoneMor , the Partnership or the Company) was created to own and operate the cemetery and funeral home business conducted by Cornerstone Family Services Inc. and its subsidiaries ( 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. The consolidated statements included herein are for Cornerstone for periods prior to 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. Since that time, Cornerstone acquired ten additional cemeteries and one funeral home, built two funeral homes and sold one cemetery.

**Interim Financial Data** The interim financial data are unaudited. However, in the opinion of management, the interim financial data as of March 31, 2005 and for the three months ended March 31, 2005 and 2004 include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods. The results of operations for interim periods are not necessarily indicative of the results of operations to be expected for a full year.

**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 a 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. Concurrent with the initial public offering, the Partnership's wholly owned subsidiary, StoneMor Operating LLC, and its subsidiaries, all as borrowers, issued and sold \$80.0 million in aggregate principal amount of senior secured notes in a private placement and entered into a \$12.5 million revolving credit facility and a \$22.5 million acquisition facility with a group of banks. The net proceeds of the initial public offering and the sale of senior secured notes were used to repay the debt and associated accrued interest of approximately \$135.1 million of CFSI LLC and \$15.7 million of fees and expenses associated with the initial public offering and the sale of senior secured notes. The remaining funds have been 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):

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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	9,364
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	2,003
Reserve for general partnership purposes	7,806
 Total use of proceeds from the sale of common units	 \$ 86,638
Use of proceeds from the issuance of senior secured notes	
Private placement fee	\$ 1,076
Other debt issuance 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

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

**Principles of Consolidation** The condensed consolidated financial statements include the accounts of each of the Company's subsidiaries and the operations of 11 managed cemeteries that the Company operates under long-term management contracts as of March 31, 2005. Prior to September 2004 we operated 12 cemeteries under management agreements. In September 2004, we converted one of these cemetery associations into a for-profit entity owned by us and ceased operating this cemetery under a management agreement. Intercompany balances and transactions have been eliminated in consolidation.

Prior to March 31, 2004, the cemeteries that the Company operated under long term management contracts were consolidated in accordance with Emerging Issues Task Force (EITF) Issue No. 97-2, Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangement. Effective March 31, 2004, the Company adopted FIN 46R (see Note 1, Accounting Change). The Company's historical policy of consolidating these cemeteries did not change with the adoption of FIN 46R.

Total revenues derived from the cemeteries under long term management contracts totaled approximately \$4.8 million and \$5.1 million for the three months ended March 31, 2004 and 2005, respectively.

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

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

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

The Company records a merchandise liability at the time it enters into a pre-need contract with a customer at the estimated cost to purchase the merchandise or provide the service. The merchandise liability is reduced when payment for the merchandise is made by the Company and title to the merchandise is transferred to the customer. The merchandise liability is also reduced when the contracted service is performed by the Company. Allowances for customer cancellations arising from non-payment are provided at the date of sale based upon management's estimates of expected cancellations and historical experience. Actual cancellation rates in the future may result in a change in estimate. Actual cancellations did not vary significantly from the estimates of expected cancellations at March 31, 2004 and March 31, 2005.

Pursuant to state law, a portion of the proceeds from cemetery merchandise or services sold on a pre-need basis is required to be paid into merchandise trusts. The Company defers investment earnings generated by the assets in these merchandise trusts (including realized gains and losses) until the associated merchandise is delivered or the services are performed. The fair value of the funds held in merchandise trusts at December 31, 2004 and March 31, 2005 was approximately \$114.8 million and \$110.0 million, respectively (see Note 6). In accordance with industry practice for periods ending prior to March 31, 2004, the Company did not consolidate these trust funds in the financial statements as the Company was not considered to have complete controlling financial interest in these trusts and the Company did not bear all of the risks and rewards of these trusts' assets. However, the principal of the funds held in merchandise trusts was reflected during these periods as due from merchandise trusts at cost on the Company's consolidated balance sheets and the earnings thereon are reflected in deferred cemetery revenues, net until such principal and earnings are recognized as revenues. As of March 31, 2004, the Company adopted Financial Accounting Standards Board Interpretation No. 46 and 46R (FIN 46R) which resulted in the consolidation of the merchandise trusts on the Company's consolidated balance sheet at fair value (See Note 1, Accounting Change).

A portion of the proceeds from the sale of cemetery property is required by state law to be paid into perpetual care trusts. Earnings from the perpetual care trusts are recognized in current cemetery revenues and are used to defray cemetery maintenance costs, which are expensed as incurred. Funds held in perpetual care trusts at December 31, 2004 and March 31, 2005 were \$127.9 million and \$126.5 million, respectively (see Note 7). As of March 31, 2004, the Company adopted FIN 46 and FIN 46R which resulted in the consolidation of the perpetual care trusts on the Company's consolidated balance sheet at fair value (See Note 1, Accounting Change).

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

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

**Inventories** Inventories, classified as other current assets on the Company's consolidated balance sheets, include cemetery and funeral home merchandise and are valued at the lower of cost or net realizable value. Cost is determined primarily on a specific identification basis on a first-in, first-out basis. Inventories were approximately \$0.8 million and \$0.9 million at December 31, 2004 and March 31, 2005, respectively.

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

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

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

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For the three months ended March 31, 2004 and 2005, depreciation expense was \$0.9 million and \$0.7 million, respectively.

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

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

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

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

***Accounting Change***

In January 2003 and December 2003, the FASB issued FASB Interpretation (FIN) No. 46 and No. 46 revised (FIN 46R), Consolidation of Variable Interest Entities: an Interpretation of Accounting Research Bulletin (ARB) No. 51. FIN 46 and FIN 46R clarify the application of ARB No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46R further defines the terms related to variable interest entities and clarifies if such entities should be consolidated. FIN 46R applies to enterprises that have a variable interest in variable interest entities and was effective for the first financial reporting period ending after March 15, 2004. The requirements of this interpretation, as revised, were applicable to the Company for the quarter ending March 31, 2004.

The adoption of FIN 46R resulted in the consolidation of the merchandise trusts (including the funeral trusts) and perpetual care trusts in the Company's consolidated balance sheet, but did not change the legal relationships among the merchandise trusts and perpetual care trusts, the Company, and its holders of pre-need contracts. To the extent that the customers are the legal beneficiaries of the merchandise trusts, the Company recognizes a non-controlling interest in merchandise trusts. The principal in the perpetual care trusts is required by state law to be held in perpetuity and is not redeemable by the Company or the customers. Accordingly the equity interest in the perpetual care trusts is presented as a non-controlling interest in perpetual care trusts between the liabilities and stockholders' equity in the Company's consolidated balance sheet. The adoption of FIN 46R did not impact the Company's net income or its condensed consolidated statement of cash flows from operating, investing or financing activities.

Both the merchandise and perpetual care trusts hold investments in marketable securities which have been classified as available-for-sale. In accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, these investments are recorded at their fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of accumulated other comprehensive income in the Company's consolidated balance sheet. Unrealized gains and losses of the merchandise trusts that are attributable to the Company that have not been earned through the performance of services or delivery of merchandise are reclassified from accumulated other comprehensive income to deferred cemetery revenues, net. Unrealized gains and losses of the merchandise trusts (including the funeral trusts) that are attributable to the non-controlling interest holders are reclassified from accumulated other comprehensive income and recognized as a non-controlling interest in merchandise trusts. Unrealized gains and losses of the perpetual care trusts are reclassified from accumulated other comprehensive income to non-controlling interest in perpetual care trusts.



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The Company recognizes realized earnings of the merchandise trusts that are attributable to the Company that have been earned as other income in the Company's consolidated statement of operations. Realized earnings of the merchandise trusts that are attributable to the Company that have not been earned through the performance of services or delivery of merchandise are recorded in deferred cemetery revenues, net, in the Company's consolidated balance sheet. Realized earnings of the merchandise trusts (including the funeral trusts) that are attributable to non-controlling interest holders are recognized as a non-controlling interest in merchandise trusts. To the extent of qualifying cemetery maintenance costs, distributable earnings from the perpetual care trusts are recognized in cemetery revenues; otherwise realized earnings of the perpetual care trusts are recognized in other income.

The cemeteries that the Company operates under long-term management contracts are subject to consolidation in accordance with the provisions of FIN 46R. The Company's historical policy to consolidate these entities did not change with the adoption of FIN 46R (See Note 1, Principles of Consolidation).

### ***New Accounting Pronouncements***

In December 2004, the FASB issued Statement No. 123 (revised 2004), *Share-Based Payment* (FAS 123R), which replaces FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123) and supercedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. FAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first annual period after June 15, 2005, with early adoption encouraged. The pro forma disclosures previously permitted under FAS 123, no longer will be an alternative to financial statement recognition. We are required to adopt FAS 123R on January 1, 2006. Under FAS 123R, we must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive options, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of FAS 123R, while the retroactive methods would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. As we issue options after January 1, 2006, we will treat them in accordance with FAS 123R.

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

***Reclassifications*** Certain amounts in the condensed consolidated financial statements for prior periods have been reclassified to conform to the current period presentation in the condensed consolidated financial statements.

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

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Disclosure of reported segment revenue:

	<b>Three Months Ended March 31, 2004      2005 (in thousands)</b>	
Revenues:		
Cemetery:		
Sales	\$ 8,738	\$ 11,277
Services and other	6,451	5,331
Investment, including realized gains from merchandise trusts and receivables	2,332	2,782
Deferred margin, recognized	448	955
	17,969	20,345
Funeral home revenues	499	621
<b>Total revenues</b>	<b>\$ 18,468</b>	<b>\$ 20,966</b>

**2. RESTATEMENT OF FINANCIAL STATEMENTS**

Subsequent to the issuance of the Company's interim condensed consolidated financial statements for the period ended March 31, 2005, the Company determined that certain of its pre-need burial vaults that it previously believed to have been installed in to the ground during the three months ended March 31, 2005, had not been installed. The Company installs burial vaults in advance of need in order to provide for a secure storage location and expedite the at-need interment process. In accordance with SAB 104, the Company recognizes revenue related to the pre-need sale of burial vaults when the Company installs them into the ground. As such, the erroneous indication that these vaults had been installed caused us to recognize revenue in advance of the revenue recognition triggering event. As a result, the Company is restating its condensed consolidated financial statements as of and for the three month period ended March 31, 2005.

The restatement generally has the effect of deferring previously recognized revenue and earnings until later periods.

In addition, the Company determined that Deferred Selling and Obtaining Costs related to its pre-need sales should be classified as an asset of the Company instead of as a reduction of Deferred Revenues, net.

The following is a summary of the significant impacts of the restatements on the condensed consolidated financial statements.

**Table of Contents****Condensed Consolidated Statement of Income**  
(in thousands, except per unit data)

As Previously

	Reported	Adjustment	As Restated
Three months ended March 31, 2005:			
Cemetery revenues	20,486	(141)	20,345
Cost of goods sold, merchandise	1,295	(16)	1,279
Selling expense	4,226	(35)	4,191
Operating profit	2,559	(90)	2,469
Net income	758	(90)	668
General partners interest in net income for the period	15	(2)	13
Limited partners interest in net income for the period, common	371	(44)	327
Limited partners interest in net income for the period, subordinated	371	(44)	327
Net income per limited partner (common) unit (basic and diluted)	0.09	(0.01)	0.08

**Condensed Consolidated Balance Sheet**  
(in thousands)

As Previously

	Reported	Adjustment	As Restated
At March 31, 2005:			
Deferred Selling and Obtaining Costs		29,161	29,161
Total Assets	485,647	29,161	514,808
Deferred Cemetery Revenues, net	127,207	29,251	156,458
Total Liabilities	247,509	29,251	276,760
General partners equity	1,589	(2)	1,587
Limited partners equity, common	71,089	(45)	71,044
Limited partners equity, subordinated	38,959	(44)	38,915
Total Liabilities and Partners Equity	485,647	29,161	514,808

At December 31, 2004:

Deferred Selling and Obtaining Costs		28,625	28,625
Total Assets	494,467	28,625	523,092
Deferred Cemetery Revenues, net	127,426	28,625	156,051
Total Liabilities	251,201	28,625	279,826
Total Liabilities and Partners Equity	494,467	28,625	523,092

**Condensed Consolidated Statement of Cash Flow**  
(in thousands)

As Previously

	Reported	Adjustment	As Restated
Three months ended March 31, 2005:			
Operating Activities			
Net income	758	(90)	668
Deferred cemetery revenue	2,640	90	2,730
Net cash provided in operating activities	3,342		3,342

**3. LONG-TERM ACCOUNTS RECEIVABLE, NET OF ALLOWANCE**

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

December 31,      March 31,

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	2004	2005
	(in thousands)	
Customer receivables	\$ 74,123	\$ 72,695
Unearned finance income	(7,294)	(7,035)
Allowance for contract cancellations	(8,948)	(8,609)
	57,881	57,051
Less: current portion - net of allowance	25,479	25,673
Long-term portion - net of allowance	\$ 32,402	\$ 31,378

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Activity in the allowance for contract cancellations is as follows:

	December 31,	March 31,
	2004	2005
	(in thousands)	
Balance - Beginning of period	\$ 8,806	\$ 8,948
Reserve on acquired contracts		
Provision for cancellations	6,681	1,622
Charge-offs - net	(6,539)	(1,961)
Balance - End of period	\$ 8,948	\$ 8,609

**4. CEMETERY PROPERTY**

Cemetery property consists of the following:

	December 31,	March 31,
	2004	2005
	(in thousands)	
Developed land	\$ 21,684	\$ 21,390
Undeveloped land	98,075	98,075
Mausoleum crypts and lawn crypts	30,456	30,141
Total	\$ 150,215	\$ 149,606

**5. PROPERTY AND EQUIPMENT**

Major classes of property and equipment follow:

	December 31,	March 31,
	2004	2005
	(in thousands)	
Building and improvements	\$ 20,829	\$ 20,918
Furniture and equipment	19,353	20,042
	40,182	40,960
Less: accumulated depreciation	(17,566)	(18,236)
Property and equipment - net	\$ 22,616	\$ 22,724

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

**Cemetery** In connection with the pre-need sale of cemetery interment rights, merchandise and services, the customer typically enters into an installment contract with the Company. The contract is usually for a period not to exceed 60 months with payments of principal and interest required. Interest is imputed for contracts that do not bear a market rate of interest (at a rate of 5.75% during the year ended December 31, 2004 and 6.75% during the three months ended March 31, 2005). The Company establishes an allowance for cancellations due to non-payment at the

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date of sale based on historic experience and management's estimates. The allowance is reviewed quarterly and changes in estimates are reflected for current and prior contracts as a result of recent cancellation experience. Actual cancellation rates in the future may result in a change in estimate.

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

At March 31, 2004, in accordance with FIN 46R, the Company consolidated the merchandise trusts. As a result the Company recorded the merchandise trusts as trust investments by reclassifying the amounts previously in merchandise trust receivable, approximately \$2.6 million at March 31, 2004, and due from merchandise trusts, approximately \$112.3 million at March 31, 2004, into merchandise trusts, restricted, at fair value. Additionally, the Company increased the merchandise trusts, restricted, at fair value account by \$5.2 million to reflect the previously unrecognized net unrealized gains on investments held by the merchandise trusts as of March 31, 2004. The offset to this amount was initially recorded in other comprehensive income and then reclassified to deferred revenues.

At December 31, 2004, the cost and market value associated with the assets held in merchandise trusts follows:

	Cost	Gross		Market
		Unrealized Gains	Unrealized Losses	
		(In Thousands)		
Short-term investment	\$ 9,474	\$	\$	\$ 9,474
Fixed maturities:				
U.S. Government and federal agency	3,152	20	(32)	3,140
U.S. State and local government agency	1,729	19	(4)	1,744
Corporate debt securities	5,465	26	(116)	5,375
Other debt securities	62,057	640	(173)	62,524
Total fixed maturities	72,403	705	(325)	72,783
Equity securities	30,941	1,973	(373)	32,541
Total	\$ 112,818	\$ 2,678	\$ (698)	\$ 114,798

At March 31, 2005, the cost and market value associated with the assets held in merchandise trusts follows:

	Cost	Gross		Market
		Unrealized Gains	Unrealized Losses	
		(In Thousands)		
Short-term investment	\$ 10,967	\$	\$	\$ 10,967
Fixed maturities:				
U.S. Government and federal agency	2,843	9	(47)	2,805
U.S. State and local government agency	1,826	3	(11)	1,818
Corporate debt securities	5,458	18	(233)	5,243
Other debt securities	49,535	264	(1,119)	48,680

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Total fixed maturities	59,662	294	(1,410)	58,546
Equity securities	40,232	894	(658)	40,468
Total	\$ 110,861	\$ 1,188	\$ (2,068)	\$ 109,981



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An aging of unrealized losses on the Company's investments in fixed maturities and equity securities at March 31, 2005 is presented below:

	Less than 12 months		12 Months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
<b>Fixed maturities:</b>						
U.S. Government and federal agency	\$ 1,325	\$ 29	\$ 775	\$ 18	\$ 2,100	\$ 47
U.S. State and local government agency	741	7	524	4	1,265	11
Corporate debt securities	3,688	179	754	54	4,442	233
Other debt securities	42,713	1,119			42,713	1,119
<b>Total fixed maturities</b>	<b>48,467</b>	<b>1,334</b>	<b>2,053</b>	<b>76</b>	<b>50,520</b>	<b>1,410</b>
<b>Equity securities</b>	<b>13,410</b>	<b>658</b>			<b>13,410</b>	<b>658</b>
<b>Total</b>	<b>\$ 61,877</b>	<b>\$ 1,992</b>	<b>\$ 2,053</b>	<b>\$ 76</b>	<b>\$ 63,930</b>	<b>\$ 2,068</b>

The Company considers various factors when considering if a decline in fair value of an asset is other than temporary, including but not limited to the length of time and magnitude of the unrealized loss; the volatility of the investment; the credit ratings of the issuers of the investments; and the Company's intentions to sell or ability to hold the investments. At March 31, 2005, the Company has concluded that the declines in the fair values of the Company's investments in fixed maturities and equity securities held by the merchandise trusts are temporary.

The Company deposited \$3,519 and withdrew \$7,992 from the trusts during the three month period ended March 31, 2005.

**Funeral Home** Prearranged funeral home services provide for future funeral home services generally determined by prices prevailing at the time that the contract is signed. A portion of the payments made under funeral home pre-need contracts is placed in funeral trusts. Amounts used to defray the initial cost of administration are not placed in trust. The balance of the amounts in the trusts totaled approximately \$0.7 million at December 31, 2004 and approximately \$0.6 million at March 31, 2005 and are included within the merchandise trusts above. Funeral trust principal, together with investment earnings retained in trust, are deferred until the service is performed. Upon performance of the contracted funeral home service, the Company recognizes the funeral trust principal amount together with the accumulated trust earnings as funeral home revenues.

**7. PERPETUAL CARE TRUSTS.**

At March 31, 2004, in accordance with FIN 46R, the Company consolidated the perpetual care trusts. As a result, the Company now records the perpetual care trusts, at fair value, as trust investments.

At December 31, 2004 the cost and market value associated with the assets held in perpetual care trust follows:

	Cost	Gross	Gross	Market
		Unrealized	Unrealized	
		Gains	Losses	
		(In Thousands)		
Short-term investment	\$ 11,368	\$	\$	\$ 11,368
<b>Fixed maturities:</b>				
U.S. Government and federal agency	3,468	7	(24)	3,451
U.S. State and local government agency	2,195	32	(13)	2,214

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Corporate debt securities	10,148	615	(193)	10,570
Other debt securities	70,172	3,207	(4)	73,375
<b>Total fixed maturities</b>	<b>85,983</b>	<b>3,861</b>	<b>(234)</b>	<b>89,610</b>
Equity Securities	23,162	3,878	(69)	26,971
<b>Total</b>	<b>\$ 120,513</b>	<b>\$ 7,739</b>	<b>\$ (303)</b>	<b>\$ 127,949</b>

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At March 31, 2005 the cost and market value associated with the assets held in perpetual care trust follows:

	Cost	Gross	Gross	Market
		Unrealized	Unrealized	
		Gains	Losses	
		(In Thousands)		
Short-term investment	\$ 9,922	\$	\$	\$ 9,922
Fixed maturities:				
U.S. Government and federal agency	3,662	43	(56)	3,649
U.S. State and local government agency	1,621	13	(19)	1,615
Corporate debt securities	10,399	378	(302)	10,475
Other debt securities	65,796	1,261	(201)	66,856
<b>Total fixed maturities</b>	<b>81,478</b>	<b>1,695</b>	<b>(578)</b>	<b>82,595</b>
Equity Securities	31,421	2,834	(271)	33,984
<b>Total</b>	<b>\$ 122,821</b>	<b>\$ 4,529</b>	<b>\$ (849)</b>	<b>\$ 126,501</b>

An aging of unrealized losses on the Company's investments in fixed maturities and equity securities at March 31, 2005 held in perpetual care trusts is presented below:

	Less than 12 months		12 Months or more		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses	Value	Losses
	(In Thousands)					
Fixed maturities:						
U.S. Government and federal agency	\$ 2,782	\$ 54	\$ 51	\$ 1	\$ 2,833	\$ 55
U.S. State and local government agency	835	11	237	8	1,072	19
Corporate debt securities	3,857	224	648	78	4,505	302
Other debt securities	5,489	201	46	1	5,535	202
<b>Total fixed maturities</b>	<b>12,963</b>	<b>490</b>	<b>982</b>	<b>88</b>	<b>13,945</b>	<b>578</b>
Equity Securities	8,556	271			8,556	271
<b>Total</b>	<b>\$ 21,519</b>	<b>\$ 761</b>	<b>\$ 982</b>	<b>\$ 88</b>	<b>\$ 22,501</b>	<b>\$ 849</b>

The Company considers various factors when considering if a decline in fair value of an asset is other than temporary, including but not limited to the length of time and magnitude of the unrealized loss; the volatility of the investment; the credit ratings of the issuers of the investments; and the Company's intentions to sell or ability to hold the investments. At March 31, 2005 the Company has concluded that the declines in the fair values of the Company's investments in fixed maturities and equity securities held in perpetual care trusts are temporary.

The Company deposited \$892 and withdrew \$1,875 from the trusts during the three month period ended March 31, 2005.

The Company recorded income from perpetual care trusts of \$1.7 million for the three months ended March 31, 2004 and 2005. This income is classified as cemetery revenues in the consolidated statements of operations.

**8. LONG-TERM DEBT**

The following is a summary of debt outstanding at:

	December 31,	March 31,
	2004	2005
	(In Thousands)	
Senior secured notes, due 2009 (interest rate - 7.66%)	80,000	80,000
Total	80,000	80,000
Less current portion		
Long-term portion	\$ 80,000	\$ 80,000

On March 31, 1999, the Company entered into a \$200.0 million credit facility with a group of banks and Wachovia Bank, formerly First Union National Bank, as administrative and collateral agent. The credit facility consisted of a \$100.0 million term loan and a \$100.0 million revolving credit facility. The proceeds of the term loan and \$27.5 million of the revolving credit facility were used by the Company to finance the acquisition of 123 cemeteries and 4 funeral homes.

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On April 8, 2004, the Company amended and restated its credit agreement. This amendment extended the Company's then existing revolving credit facility maturity date to June 2005 from September 2004. This amendment also changed the quarterly principal payments on the term loan from \$7.5 million per quarter beginning June 2004 through March 31, 2005 and \$21.5 million per quarter beginning April 1 through December 31, 2005 with the balance to be paid in full March 31, 2006 to \$1.25 million due on March 2004 and \$2.0 million due quarterly from June 2004 through March 2005 with the remainder due June 2005. The Company paid approximately \$1.4 million in fees to the banks in connection with this refinancing.

On September 20, 2004, concurrent with the closing of the Partnership's initial public offering, StoneMor Operating LLC and its subsidiaries issued and sold \$80.0 million aggregate principal amount of senior secured notes. The senior secured notes bear interest at a rate of 7.66% per annum and mature in 2009. The senior secured notes rank pari passu with all of our other senior secured debt, including the revolving credit facility and the acquisition facility, subject to the description of the collateral securing the senior secured notes described below. The senior secured notes are guaranteed by the Partnership, the general partner of the Partnership and any future subsidiaries of StoneMor Operating LLC. Obligations under the senior secured notes are secured by a first priority lien and security interest covering substantially all of the assets of the issuers of the senior secured notes, whether then owned or thereafter acquired, other than specified receivable rights and a second priority lien and security interest covering those specified receivable rights, each as described above, of such issuers, whether then owned or thereafter acquired.

On September 20, 2004, concurrent with the closing of the Partnership's initial public offering, StoneMor Operating LLC and its subsidiaries entered into a new \$35.0 million credit facility with a group of banks. This credit facility consists of a \$12.5 million revolving credit line and a \$22.5 million acquisition line of credit. Borrowings under the revolving credit line are due and payable on September 20, 2007, and borrowings under the acquisition line of credit are due and payable on September 20, 2008. Depending on the type of loan, this credit facility bears interest at the Base Rate or the Eurodollar Rate, plus applicable margins ranging from 0.00% to 1% and 2.5% to 3.5% per annum, respectively, depending on our ratio of total debt to consolidated EBIDTA, as defined. The Base Rate is the higher of the federal funds rate plus 0.05% or the prime rate announced by Fleet National Bank, a Bank of America Company. The Eurodollar Rate is to be determined by the administrative agent according to the new credit facility. As of March 31, 2005 we had no outstanding borrowings under this credit facility. On April 26, 2005, we borrowed \$1.6 million from the revolving credit line to fund working capital items related to annual payments for annual expenditures.

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

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

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

The agreements governing the revolving credit facility, the acquisition line of credit and the senior secured notes contain restrictive covenants that, among other things, prohibit distributions upon defined events of default, restrict investments and sales of assets and require us to maintain certain financial covenants, including specified financial ratios. As of March 31, 2005, the Company was in compliance with all covenants.

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Deferred financing costs as of March 31, 2005 consisted of approximately \$2.7 million of debt issuance costs, less accumulated amortization of approximately \$0.4 million. These costs were incurred in connection with the issuance of the Company's debt during September 2004.

**9. INCOME TAXES**

As of December 31, 2004, the Company's taxable corporate subsidiaries had a federal net operating loss carryover of approximately \$37.3 million, which will begin to expire in 2019. As of December 31, 2004, the Company also had a state net operating loss carry-forward of approximately \$54.8 million, which will begin to expire in 2005.

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

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

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

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

The provision for income taxes for the three months ended March 31, 2004 and 2005 is based upon the estimated annual effective tax rates expected to be applicable to the Company for 2004 and 2005, respectively.

**10. DEFERRED CEMETERY REVENUES - NET / DEFERRED SELLING AND OBTAINING COSTS**

In accordance with SAB No. 104, the Company defers the revenues and all direct costs associated with the sale of pre-need cemetery merchandise and services until the merchandise is delivered or the services are performed. The Company also defers the costs to obtain new pre-need cemetery and new prearranged funeral business as well as the investment earnings on the prearranged services and merchandise trusts (see Note 1). At December 31, 2004 and March 31, 2005, deferred cemetery revenues, net, consisted of the following:

	December 31,	March 31,
	2004	2005
	(In Thousands)	
Deferred cemetery revenue	\$ 127,296	\$ 130,309
Deferred merchandise trust revenue	23,519	22,035
Deferred pre-acquisition margin	25,515	24,561
Deferred cost of good sold	(20,279)	(20,447)
<b>Deferred Cemetery Revenues, net</b>	<b>\$ 156,051</b>	<b>\$ 156,458</b>
Deferred selling and obtaining costs	\$ 28,625	\$ 29,161

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

**11. COMMITMENTS AND CONTINGENCIES**

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

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**Leases** At March 31, 2005, the Company was committed to operating lease payments for premises (the corporate headquarters was leased from a related party during the year ended December 31, 2003), automobiles and office equipment under various operating leases with initial terms ranging from one to five years and options to renew at varying terms. Expenses under operating leases were \$0.1 million for the three months ended March 31, 2004 and 2005.

At March 31, 2005, operating leases will result in future payments in the following approximate amounts:

	(in thousands)
2005	\$ 393
2006	531
2007	551
2008	531
2009	506
Thereafter	1,660
<b>Total</b>	<b>\$ 4,172</b>

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



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

The following discussion and analysis gives effect to the restatement as discussed in Note 2 to the condensed consolidated financial statements.

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

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

#### **Overview**

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

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

**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 a 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. Concurrent with the initial public offering, the Partnership's wholly owned subsidiary, StoneMor Operating LLC, and its subsidiaries, all as borrowers, issued and sold \$80.0 million in aggregate principal amount of senior secured notes in a private placement and entered into a \$12.5 million revolving credit facility and a \$22.5 million acquisition facility with a group of banks. The net proceeds of the initial public offering and the sale of senior secured notes were used to repay the debt and associated accrued interest of approximately \$135.1 million of CFSI LLC and \$15.7 million of fees and expenses associated with the initial public offering and the sale of senior secured notes. The remaining funds have been 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

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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	9,364
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	2,003
Reserve for general partnership purposes	7,806
 Total use of proceeds from the sale of common units	 \$ 86,638
Use of proceeds from the issuance of senior secured notes	
Private placement fee	\$ 1,076
Other debt issuance 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

We are an owner and operator of cemeteries in the United States of America. As March 31, 2005, the Company operated 132 cemeteries in 12 states, located primarily in the eastern United States of America. The Company owns 122 of these cemeteries and operates the remaining 11 under long-term management agreements with cemetery associations that own the cemeteries. As a result of the agreements and other control arrangements, StoneMor consolidates the results of the 11 managed cemeteries in our historical consolidated financial statements.

StoneMor sells cemetery products and services both at the time of death, which the Company refers to as at-need, and prior to the time of death, which the Company refers to as pre-need. During the first three months of 2005, StoneMor performed over 5,900 burials and sold more than 2,700 interment rights (net of cancellations) compared to 6,000 and 3,500, respectively for the same period of 2004.

**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;

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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

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other items, such as interest income on pre-need installment contracts and sales of land. Revenues from pre-need sales of cemetery merchandise and the related accumulated merchandise trust earnings are deferred until the merchandise is delivered to the customer, which generally means that:

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

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

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

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

*Deferred Cemetery Revenues, Net.* Deferred revenues from pre-need sales and related merchandise trust earnings are reflected on our balance sheet in deferred cemetery revenues, net, until we recognize the amounts as revenues. Deferred cemetery revenues, net, also includes deferred revenues from pre-need sales that were entered into by entities we acquired prior to the time we acquired them. These entities include those that we acquired at the time of the formation of Cornerstone and other entities we subsequently acquired. We recognize revenues from these acquired pre-need sales in the manner described above—that is, when we deliver the merchandise to, or perform the services for, the customer. Our profit margin on these pre-need sales is generally less than our profit margin on other pre-need sales because, in accordance with industry practice at 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 sale when we recognize the revenues from that sale. Under current industry practice, we recognize certain expenses, such as indirect selling costs, maintenance costs and general and administrative costs, at the time the pre-need sale is made and defer other expenses, such as direct selling costs and costs of goods sold, until we recognize revenues on the sale. As a result, our profit margin on current pre-need sales is generally higher than on the pre-need sales we acquired.

## **Funeral Home Operations**

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

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

Each of our seven funeral homes is located on the grounds of one of the cemeteries that we own. As a result, we are able to combine certain general and administrative expenses that relate to both the cemetery and the funeral home at the same location. Our other funeral home operating expenses consist primarily of compensation to our funeral directors and the cost of caskets.

## **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based on the historical consolidated financial statements of Cornerstone and the historical consolidated financial statements of StoneMor. We prepared these financial statements in conformity with Generally Accepted Accounting Principles. The preparation of these financial statements required us to make estimates, judgments and assumptions that affected the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We based our estimates, judgments and assumptions on historical experience and known facts and other assumptions that we believed to be reasonable under the circumstances. In future periods, we expect to make similar estimates,

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judgments and assumptions on the same basis as we have historically. Our actual results in future periods may differ from these estimates under different assumptions and conditions. We believe that the following accounting policies or estimates had or will have the greatest potential impact on our consolidated financial statements for the periods discussed and for future periods.

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

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

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

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

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

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

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

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

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

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



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As of December 31, 2004, Stonemor Partners L.P., and its affiliated group of corporate subsidiaries had a consolidated federal net operating loss carryover of approximately \$37.3 million and state net operating losses of approximately \$54.8 million. These federal and state net operating losses will begin to expire in 2019 and 2005, respectively, and 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. For additional information about, among other things, our pre-need sales, at-need sales, trusting requirements, cash flow, expenses and operations, please see Management's Discussion and Analysis of Financial Condition and Results of Operations included in our annual report on Form 10-K and our other reports and statements filed with the SEC.

## **Recent Accounting Pronouncements**

In January 2003 and December 2003, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation (FIN) No. 46 and 46 revised, Consolidation of Variable Interest Entities: an Interpretation of Accounting Research Bulletin (ARB) No. 51. FIN 46R clarifies the application of ARB No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46R defines the terms related to variable interest entities and clarifies whether such entities should be consolidated. FIN 46R applies to enterprises that have a variable interest in variable interest entities and is effective for the first financial reporting period ending after March 15, 2004. The requirements of this interpretation, as revised, have been applicable to us since the quarter ended March 31, 2004.

The adoption of FIN 46R resulted in the consolidation of the merchandise trusts and perpetual care trusts in our consolidated balance sheet after such adoption, but did not change the legal relationships among the merchandise trusts, the perpetual care trusts, holders of our pre-need contracts and us. The implementation of FIN 46R had no impact on our net loss or cash flows from operating, investing or financing activities for the three months ended March 31, 2005. See Note 1 to our unaudited condensed consolidated financial statements for a further discussion of the adoption of FIN 46R.

In December 2004, the FASB issued Statement No. 123 (revised 2004), *Share-Based Payment* (FAS 123R), which replaces FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123) and supercedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. FAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first interim or annual period after June 15, 2005, with early adoption encouraged. The pro forma disclosures previously permitted under FAS 123, no longer will be an alternative to financial statement recognition. We are required to adopt FAS 123R on January 1, 2006. Under FAS 123R, we must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive options, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of FAS 123R, while the retroactive methods would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. Currently, we have no outstanding securities that meet the definition of FAS 123R.

## **Risk Factors**

Readers of the Quarterly Report on Form 10-Q/A are referred to our annual report on Form 10-K for additional information concerning factors, risks and uncertainties with respect to the Partnership's business and rules and regulations affecting the Partnership.

## **Forward-Looking Statements**

Certain statements contained in this quarterly report on Form 10-Q/A, 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, predict and similar expressions are forward-looking statements. These forward-looking statements are made subject to certain risks and uncertainties that could cause actual results to differ





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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; and various other uncertainties associated with the death care 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 in our annual report on Form 10-K and our other reports and statements filed with the SEC. 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.

**Results of Operations**

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

	Cornerstone	
	Family	StoneMor
	Services, Inc.	Partners L.P.
	Three months ended	
	March 31,	
	2004	2005
	(in thousands)	
<b>Statement of Operations Data:</b>		
Revenues:		
Cemetery	\$ 17,969	\$ 20,345
Funeral home	499	621
<b>Total</b>	<b>18,468</b>	<b>20,966</b>
Costs and Expenses:		
Cost of goods sold:		
Land and crypts	828	963
Perpetual care	633	615
Merchandise	763	1,279
Cemetery expense	4,673	4,717
Selling expense	3,855	4,191
General and administrative expense	2,483	2,378
Corporate overhead	2,435	3,075
Depreciation and amortization	1,265	845
Funeral home expense	432	434
Interest expense	2,532	1,581
Income taxes (benefit)	(43)	220
<b>Net income (loss)</b>	<b>\$ (1,388)</b>	<b>\$ 668</b>

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

	Cornerstone	
	Family	StoneMor
	Services, Inc.	Partners L.P.
	Three months ended	
	March 31,	
	2004	2005
<b>Operating Data:</b>		
Interments Performed	6,038	5,978
Cemetery revenues per interment performed	2,976	3,403
Interment rights sold (1):		
Lots	2,926	2,207
Mausoleum crypts (including pre-construction)	484	421
Niches	95	104
Total interment rights sold	3,505	2,732
Number of contracts written	11,570	10,782
Aggregate contract amount, in thousands (excluding interest)	22,680	21,429
Average amount per contract (excluding interest)	1,960	1,987
Number of pre-need contracts written	5,225	4,495
Aggregate pre-need contract amount, in thousands (excluding interest)	14,721	13,337
Average amount per pre-need contract (excluding interest)	2,732	2,967
Number of at-need contracts written	6,345	6,287
Aggregate at-need contract amount, in thousands	7,959	8,092
Average amount per at-need contract	1,254	1,287

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

**Three Months Ended March 31, 2005 versus Three Months Ended March 31, 2004**

*Cemetery Revenues.* Cemetery revenues were \$20.3 million in the first three months of 2005, an increase of \$2.3 million, or 12.8%, as compared to \$18.0 million in the first three months of 2004. Cemetery revenues from pre-need sales, including interest income from pre-need installment contracts and investment income from trusts, were \$12.3 million in the first three months of 2005, an increase of \$3.0 million, or 32.3%, as compared to \$9.3 million in the first three months of 2004. The increase primarily resulted from more casket deliveries (\$1.4 million), more marker and marker base deliveries (\$1.0 million), and more vault deliveries (\$0.1 million). An additional contribution to the increase in cemetery revenues from pre-need sales was higher accumulated earnings from merchandise trusts allocated to the pre-need products delivered during the first three months of 2005. Total revenues from merchandise and perpetual care trusts for the first three months of 2005 were higher by \$0.5 million than the same period in 2004.

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Cemetery revenues from at-need sales in the first three months of 2005 were \$7.9 million, an increase of \$0.4 million, or 5.3%, as compared to \$7.5 million in the first three months of 2004. The increase in cemetery revenues from at-need sales was primarily attributable to higher sales of monument bases and markers of \$0.2 million and higher sales of at-need interment rights of \$0.2 million.

Other cemetery revenues were \$0.1 million in the first three months of 2005, a decrease of \$1.0 million, or 90.9%, from \$1.1 million in the first three months of 2004. The decrease in other cemetery revenues was primarily attributable to a decrease in one-time sales of undeveloped land for net proceeds of \$0.8 million.

*Costs of Goods Sold.* Cost of goods sold was \$2.9 million in the first three months of 2005, an increase of \$0.7 million, or 31.8%, as compared to \$2.2 million in the first three months of 2004. As a percentage of cemetery revenues, cost of goods sold increased to 14.0% in the first three months of 2005 from 12.4% in the first three months of 2004. The increase in cost of goods sold as a percentage of cemetery revenues was attributable to the lower gross profit margin achieved on the sale of interment rights (lots and mausoleums) related to the cost of the land or mausoleum sold. The gross profit margin on lots was 68.6% in the first three months of 2005 as compared to 72.8% in the first three months of 2004. The gross profit margin on mausoleums was 67.3% in the first three months of 2005, as compared to 68.7% in the first three months of 2004.

*Selling Expense.* Total selling expense was \$4.2 million in the first three months of 2005, an increase of \$0.3 million, or 7.7% as compared to \$3.9 million in the first three months of 2004. Sales commissions and other compensation expenses contributed \$3.2 million to total selling expense during the first three months of 2005, an increase of \$0.6 million, or 23.1%, compared to \$2.6 million in the first three months of 2004. As a percentage of pre-need sales, sales commissions and other compensation expenses were 33.6% in the first three months of 2005, as compared to 41.9% in the first three months of 2004, due to the composition of the contracts serviced.

*Cemetery Expense.* Cemetery expense was \$4.7 million in the first three months of 2005, unchanged from the same period in 2004, as we performed approximately the same number of interments in both periods.

*General and Administrative Expense.* General and administrative expense was \$2.4 million in the first three months of 2005, a decrease of \$0.1 million, or 4.0%, as compared to \$2.5 million in the first three months of 2004. The decrease was primarily attributable to a decrease in insurance costs of \$0.1 million.

*Funeral Home Revenues and Expense.* Funeral home revenues were \$0.6 million in the first three months of 2005, an increase of \$0.1 million, or 20.0%, as compared to \$0.5 million in the first three months of 2004. The primary reason for the increase was a result of the number of services performed, 189 in first three months of 2005 compared to 166 in the same period of 2004. Funeral home expense was \$0.4 million in the first three months of 2005, unchanged from 2004.

*Corporate Overhead.* Corporate overhead was \$3.1 million in the first three months of 2005, an increase of \$0.7 million, or 29.2%, as compared to \$2.4 million in the first three months of 2004. The increase was primarily related to an increase of \$0.4 million in professional fees related to tax preparation and internal control documentation and an increase of \$0.2 million in directors and officers insurance premiums.

*Depreciation and Amortization.* Depreciation and amortization was \$0.8 million in the first three months of 2005, a decrease of \$0.5 million, or 38.5%, as compared to \$1.3 million in the first three months of 2004. The decrease was primarily attributable to decreased amortization of our debt issuance costs, the majority of which we wrote off in conjunction with our initial public offering on September 20, 2004.

*Interest Expense.* Interest expense was \$1.6 million in the first three months of 2005, a decrease of \$0.9 million, or 36.0%, as compared to \$2.5 million in the first three months of 2004. This decrease is attributable to the completion of our September 20, 2004 initial public offering of which we used a portion of the proceeds to reduce our outstanding debt from \$122.7 million at March 31, 2004 to \$80.0 million at March 31, 2005, and reduced our borrowing rate from 8.0% per annum to 7.66% per annum by issuing and selling \$80.0 million aggregate principal amount of senior secured notes, the proceeds of which were used to repay our former credit facility.

*Provision (Benefit) for Income Taxes.* Provision for income taxes was \$0.2 million in the first three months of 2005 as compared to a benefit for income taxes of \$43,000 during the first three months of 2004. The change in provision (benefit) for income taxes was primarily due to the change in tax status from a corporation to a partnership.

StoneMor Partners L.P. is treated as a partnership for federal income taxes purposes.

*Net Income(Loss).* Net income was \$0.7 million during the first three months of 2005, an increase of \$2.1 million, or 150.0%, as compared to a net loss of \$1.4 million during the first three months of 2004. The increase in net income was primarily attributable to the increase in operating

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profit of \$1.4 million, a decrease in interest expense of \$0.9 million, partially offset by an increase in the provision for income taxes of \$0.2 million.

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*Deferred Cemetery Revenue.* Deferred cemetery revenues, net, increase \$0.4 million, or 0.3% in the first three months of 2005, from \$156.0 million as of December 31, 2004 to \$156.4 million. In the comparable period in 2004, deferred cemetery revenues, net, increased \$9.0 million, or 6.4%, from \$140.8 million as of December 31, 2003 to \$149.8 million as of March 31, 2004. The net increase in the first three months of 2005 was primarily attributable to a decrease in delivery of pre-need cemetery products and services that were sold in prior periods. In the three months ended March 31, 2005, we added \$10.2 million in pre-need sales of cemetery merchandise and services, net of deferred costs and cancellations, to our pre-need sales backlog which was offset by revenues recognized, net of costs, of \$6.5 million, including accumulated merchandise trust earnings related to the delivery and performance of pre-need cemetery merchandise and services. In the three months ended March 31, 2004, we added \$11.5 million in pre-need sales of cemetery merchandise and services, net of deferred costs and cancellations, to our pre-need sales backlog which was offset by revenues recognized, net of costs, of \$7.3 million, including accumulated merchandise trust earnings related to the delivery and performance of pre-need cemetery merchandise and services.

## **Liquidity and Capital Resources**

*Overview.* Our primary short-term operating liquidity needs are to fund general working capital requirements and maintenance capital expenditures. Our long-term operating liquidity needs are primarily associated with acquisitions of cemetery properties and the construction of mausoleum crypts and lawn crypts on the grounds of our cemetery properties. We may also construct funeral homes on the grounds of cemetery properties that we acquire in the future. Our primary source of funds for our short-term liquidity needs 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 new 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. We anticipate ongoing annual capital expenditure requirements of between approximately \$1.7 million and \$2.9 million for the foreseeable future, of which between \$1.1 million and \$2.0 million is for maintenance of our existing cemeteries and between \$0.6 million and 0.8 million is for mausoleum and lawn crypt construction and other expansion, excluding acquisitions. The estimate for cemetery maintenance capital expenditures would increase if we were to acquire additional cemetery properties.

One of our goals is to grow through the acquisition of high-quality cemetery properties. We anticipate financing these 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 under our credit facility, the senior secured notes and our partnership agreement. Since Cornerstone began operations in 1999, we have acquired ten cemetery properties ranging in price per cemetery from \$0.2 million to \$11.0 million and having an aggregate purchase price of \$27.4 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 \$3.3 million in the first three months of 2005 compared to cash used in operating activities of \$0.1 million during the first three months of 2004. Cash flows from operating activities in the first three months of 2005 included payments of approximately \$1.5 million for corporate bonuses that were earned and expensed in 2004 but paid in the first three months of 2005. Cash used in operating activities in the first three months of 2004 were \$0.1 million and included payments of \$1.7 million for corporate bonuses that were earned and expensed in 2003 but paid in the first three months of 2004 and \$1.0 million of professional fees paid related to our initial public offering which was completed on September 20, 2004. The remaining change in cash outflows was primarily attributable to the net income of \$1.0 million recorded during the first three months of 2005 as compared to a net loss of \$1.4 million during the first three months of 2004 and changes in working capital.

*Cash Flow from Investing Activities.* Net cash used in investing activities was \$1.0 million in the first three months of 2005, an increase of \$0.5 million, as compared to \$0.5 million in the first three months of 2004. This increase was primarily attributable to an increase in expenditures for upgrades to our vault manufacturing plant of \$0.3 million and an increase in acquisition of vault installation equipment of \$0.2 million.

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*Cash Flow from Financing Activities.* Net cash used in financing activities was \$4.4 million in the first three months of 2005 as compared to cash provided by financing activities of \$0.6 million in the first three months of 2004. The cash flow used in investing activities was primarily attributable to the February payment of our fourth quarter 2004 unit holder distribution of \$4.4 million. The additional change in cash flows is attributable to net borrowings of \$0.6 million under our former credit facility in the first three months of 2004.

*Credit Facility.* On September 20, 2004, we paid in full all amounts outstanding under our old credit facility, which consisted of \$26.5 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, 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.

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

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

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

Our obligations under the revolving facility are secured by a first priority lien and security interest in specified receivable rights, whether then owned or thereafter acquired, of the borrowers and the guarantors and by a 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.

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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 will share pari passu in the collateral securing the acquisition facility.

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

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

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

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

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

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

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

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

a change of control; or

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

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



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

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

the general partner ceases to be our sole general partner;

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

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

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

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

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

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

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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.

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

interest expense;

taxes;

depreciation and amortization;

non-cash cost of land and crypts;

extraordinary losses;

other non-cash items;

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

increase (decrease) in accounts receivable;

increase (decrease) in merchandise liability; and

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

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

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

enter into a new line of business;

enter into any agreement of merger or acquisition;

sell, transfer, assign or convey assets;

grant certain liens;

incur or guarantee additional indebtedness;

make certain loans, advances and investments;

declare and pay dividends and distributions;

enter into certain leases;

enter into transactions with affiliates; and

make voluntary payments or modifications of indebtedness.

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

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

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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, commencing on December 20, 2004. There will be no principal amortization prior to the final maturity of the senior secured notes.

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

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

enter into a new line of business;

enter into any agreement of merger or acquisition;

sell, transfer, assign or convey assets;

grant certain liens;

incur or guarantee additional indebtedness;

make certain loans, advances and investments;

declare and pay dividends and distributions;

enter into certain leases;

enter into transactions with affiliates; and

make voluntary payments or modifications of indebtedness.

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

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

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

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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.

The note purchase agreement was amended in November 2004 to amend the leverage ratio from 3.5 to 3.75 to 1 until September 30, 2005.

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

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

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

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

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

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

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

a change of control; or

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

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

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

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

the general partner ceases to be our sole general partner;

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

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

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

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

*Capital Expenditures*

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

	<b>Cornerstone</b>	
	<b>Family</b>	<b>StoneMor</b>
	<b>Services, Inc.</b>	<b>Partners L.P.</b>
	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2004</b>	<b>2005</b>
Maintenance capital expenditures	\$ 272	\$ 746
Expansion capital expenditures	230	227
<b>Total capital expenditures</b>	<b>\$ 502</b>	<b>\$ 973</b>

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

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

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

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The information presented below should be read in conjunction with the notes to our unaudited condensed consolidated financial statements included under Item 1 Financial Statements.

The market risk inherent in our market risk sensitive instruments and positions is the potential change arising from increases or decreases in interest rates and the prices of marketable equity securities, as discussed below. Our exposure to market risk includes forward-looking statements and represents an estimate of possible changes in fair value or future earnings that would occur assuming hypothetical future movements in interest rates or equity markets. Our views on market risk are not necessarily indicative of actual results that may occur and do not

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represent the maximum possible gains and losses that may occur, since actual gains and losses will differ from those estimated, based on actual fluctuations in interest rates, equity markets and the timing of transactions. We classify our market risk sensitive instruments and positions as other than trading.

*Interest-bearing Investments.* Our fixed-income securities subject to market risk consist primarily of investments in merchandise trusts and perpetual care trusts. As of March 31, 2005, fixed-income securities represented 53.2% of the funds held in merchandise trusts and 65.3% of the funds held in perpetual care trusts. The aggregate quoted market value of these fixed-income securities was \$58.5 million and \$82.6 million in merchandise trusts and perpetual care trusts, respectively, as of March 31, 2005. Each 1% change in interest rates on these fixed-income securities would result in changes of approximately \$0.6 million and \$0.8 million in the fair market values of the securities held in merchandise trusts and perpetual care trusts, respectively, based on discounted expected future cash flows. If these securities are held to maturity, no change in fair market value will be realized.

Our money market and other short-term investments subject to market risk consist primarily of investments held in merchandise trusts and perpetual care trusts. As of March 31, 2005, these investments accounted for approximately 10.0% and 7.8% of the funds held in merchandise trusts and perpetual care trusts, respectively. The fair market value of these investments was \$11.0 million and \$9.9 million in merchandise trusts and perpetual care trusts, respectively, as of March 31, 200. Each 10% change in average interest rates applicable to these investments would result in changes of approximately \$1.1 million and \$1.0 million, respectively; in the aggregate fair market values of the perpetual care investments and the merchandise trust investments.

*Marketable Equity Securities.* Our marketable equity securities subject to market risk consist primarily of investments held in merchandise trusts and in the case of perpetual care trusts, investments in real estate investment trusts, or REITs. As of March 31, 2005, marketable equity securities represented 36.8% of funds held in merchandise trusts and 26.9% of funds held in perpetual care trusts. The aggregate fair market value of these marketable equity securities was \$40.5 million and \$34.0 million in merchandise trusts and perpetual care trusts, respectively, as of March 31, 2005, based on final quoted sales prices. Each 10% change in the average market prices of the equity securities would result in a change of approximately \$4.1 million and \$3.4 million in the fair market value of securities held in merchandise trusts and perpetual care trusts, respectively.

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

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

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

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

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

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

Our investment guidelines are based on relatively long investment horizons, which vary with the type of trust. Because of this, interim fluctuations should be viewed with appropriate perspective. The strategic asset allocation of the trust portfolios is also based on this longer-term



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perspective. However, in developing our investment policy, we have taken into account the potential negative impact on our operations and financial performance of significant short-term declines in market value.

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

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

*Debt Instruments.* Our credit facility bears interest at a floating rate, based on LIBOR, which is adjusted quarterly. This credit facility will subject us to increases in interest expense resulting from movements in interest rates. We have no indebtedness outstanding under our credit facility.

### **Item 4. Controls and Procedures**

#### **Disclosure Controls and Procedures**

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

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's Disclosure Committee and management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b). Based upon this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were not effective because of the material weakness described below. In light of the material weakness described below, the Company performed additional analysis and other post-closing procedures to ensure our consolidated financial statements are prepared in accordance with generally accepted accounting principles. Accordingly, management believes that the consolidated financial statements included in this Annual Report on Form 10-K fairly present in all material respects our financial position, results of operations and cash flows for the periods presented.

#### **Management's Report on Internal Control over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is a process designed under the supervision of the Company's Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of March 31, 2005. In making this assessment, management used the criteria described in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. We identified the following material weaknesses in our assessment of the effectiveness of internal control over financial reporting as of March 31, 2005:

The Company did not design and implement adequate controls related to the recognition of revenue from pre-need burial vaults. Specifically, revenue should be recognized once vaults are installed and management did not have controls in place to ensure that installation had occurred prior to recognizing revenue.

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The Company's controls related to the review of financial statements to ensure that amounts are properly classified and presented in the financial statements did not operate effectively. Specifically, these controls failed to detect an error in the application of SFAS 60

Accounting and Reporting by Insurance Enterprises related to the presentation of deferred costs and revenues in the Company's statement of financial position.

These weaknesses resulted in the restatement of previously issued financial statements and material audit adjustments that were necessary to present the 2005 financial statements in accordance with generally accepted accounting principles.

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### **Plan for Remediation**

To remediate the material weakness related to the recognition of revenue from pre-need burial vaults, the Company has implemented a cemetery maintenance control procedure pursuant to which:

Each of the Company's cemetery superintendents is required to personally inspect, verify, and certify in writing as to each vault installation at the superintendent's cemetery.

The Company's regional administrators and maintenance personnel are required to perform random cemetery tests to and to verify burial vault installations on a monthly basis at cemeteries located outside of their regions.

The Company's Internal Audit Department is required to conduct periodic surprise field visits to test and verify burial vault installations.

The Company's administrative and maintenance personnel are required to undergo additional training with respect to the foregoing procedures and the importance of the Company's internal controls.

To remediate the material weakness related to balance sheet presentation, the Company restated its 2004 consolidated balance sheet.

The Company's management believes that the procedures described above will serve to remediate the material weakness identified once implemented and operating effectively.

### **Changes in Internal Control over Financial Reporting**

Except as described above, there have been no changes in the Company's internal controls over financial reporting that occurred during the Company's last fiscal quarter ended March 31, 2005 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

**Table of Contents****Part II Other Information****Item 1. Legal Proceedings**

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

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

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

**The Partnership has had no sales, grants or repurchases of equity securities during the three months ended March 31, 2005.**

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	9,364
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	2,003
Reserve for general partnership purposes	7,806
 Total use of proceeds from the sale of common units	 \$ 86,638
Use of proceeds from the issuance of senior secured notes	
Private placement fee	\$ 1,076
Other debt issuance 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

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

None.

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

None.

**Item 5. Other Information.**

None.



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**Item 6. Exhibits**

The following documents are filed or, if so indicated below, furnished as exhibits to this quarterly report on Form 10-Q/A.

**Exhibit**

<b>Number</b>	<b>Description</b>
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)
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)

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**SIGNATURES**

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

**STONEMOR PARTNERS L.P.**

By: StoneMor GP LLC  
its general partner

May 15, 2006

/s/ Lawrence Miller  
Lawrence Miller  
Chief Executive Officer,

President and Chairman of the Board of Directors

(Principal Executive Officer)

May 15, 2006

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

(Principal Financial Officer)



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Exhibit Index

**Exhibit**

<b>Number</b>	<b>Description</b>
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)
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)
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