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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2005

OR

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

For the transition period from __________ to __________

Commission file number: 1-11961

CARRIAGE SERVICES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	**76-0423828** (I.R.S. Employer Identification No.)
3040 Post Oak Boulevard, Suite 300, Houston, TX (Address of principal executive offices)	**77056** (Zip Code)

Registrant's telephone number, including area code: (713) 332-8400

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 o

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

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

The number of shares of the Registrant's Common Stock, $.01 par value per share, outstanding as of November 1, 2005 was 18,458,673.

CARRIAGE SERVICES, INC.

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PART II — OTHER INFORMATION

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CARRIAGE SERVICES, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	December 31, 2004	September 30, 2005 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,948	$ 7,335
Short term investments	—	8,979
Accounts receivable — trade, net of allowance for doubtful accounts of $940 in 2004 and $827 in 2005	12,941	13,188
Assets held for sale	4,021	—
Inventories and other current assets	12,815	14,321
Total current assets	31,725	43,823
Preneed assets	133,423	142,658
Property, plant and equipment, at cost, net of accumulated depreciation of $40,531 in 2004 and $44,788 in 2005	104,893	105,698
Cemetery property	62,649	61,787
Goodwill	156,983	157,352
Deferred obtaining costs	35,701	—
Deferred charges and other non-current assets	8,581	24,945
Cemetery perpetual care trust investments	31,201	32,855
Total assets	$ 565,156	$ 569,118
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,991	$ 3,414
Accrued liabilities	16,048	13,558
Liabilities associated with assets held for sale	2,598	—
Current portion of senior long-term debt and capital leases obligations	2,155	2,182
Total current liabilities	26,792	19,154
Senior long-term debt, net of current portion	102,714	134,886
Convertible junior subordinated debenture due in 2029 to an affiliated trust	93,750	93,750
Obligations under capital leases, net of current portion	5,424	5,369
Deferred interest on convertible junior subordinated debenture	10,891	—
Deferred revenue	176,412	184,618
Total liabilities	415,983	437,777
Commitments and contingencies		
Non-controlling interests in perpetual care trust investments	32,212	36,035
Non-controlling interests in perpetual care trust investments associated with assets held for sale	523	—
Stockholders' equity:		
Common Stock, $.01 par value; 80,000,000 shares authorized; 17,910,000 and 18,429,000 shares issued and outstanding at December 31, 2004 and September 30, 2005, respectively	179	184
Contributed capital	188,029	190,376
Accumulated deficit	(71,056)	(93,711)
Deferred compensation	(714)	(1,543)
Total stockholders' equity	116,438	95,306
Total liabilities and stockholders' equity	$ 565,156	$ 569,118

The accompanying condensed notes are an integral part of these consolidated financial statements.

CARRIAGE SERVICES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited and in thousands, except per share data)

	For the three months ended September 30,		For the nine months ended September 30,	
	2004	2005	2004	2005
Revenues, net				
Funeral	$ 26,582	$ 26,603	$ 85,054	$ 86,858
Cemetery	9,226	9,855	28,576	29,722
	35,808	36,458	113,630	116,580
Costs and expenses				
Funeral	20,475	20,506	63,097	63,668
Cemetery	7,233	8,047	21,931	24,015
	27,708	28,553	85,028	87,683
Gross profit	8,100	7,905	28,602	28,897
General and administrative expenses	2,748	3,142	7,975	8,921
Operating income	5,352	4,763	20,627	19,976
Interest expense	4,175	4,682	12,952	14,059
Additional interest and other costs of senior debt refinancing	—	—	—	6,933
Other (income) expense	423	(140)	(468)	249
Total interest and other (income) expense	4,598	4,542	12,484	21,241
Income (loss) from continuing operations before income taxes	754	221	8,143	(1,265)
(Provision) benefit for income taxes	(283)	(81)	(3,054)	483
Net income (loss) from continuing operations	471	140	5,089	(782)
Discontinued operations				
Operating income from discontinued operations	58	3	404	101
Gain on sales and (impairments) of discontinued operations	1,039	836	(2,011)	1,302
Income tax (provision) benefit	(411)	(309)	269	(522)
Income (loss) from discontinued operations	686	530	(1,338)	881
Cumulative effect of change in accounting method, net of tax benefit benefit	—	—	—	(22,756)
Net income (loss)	$ 1,157	$ 670	$ 3,751	$ (22,657)
Basic earnings (loss) per common share				
Continuing operations	$ 0.03	$ 0.01	$ 0.29	$ (0.04)
Discontinued operations	0.04	0.03	(0.08)	0.05
Cumulative effect of change in accounting method	—	—	—	(1.25)
Net income (loss)	$ 0.07	$ 0.04	$ 0.21	$ (1.24)
Diluted earnings (loss) per common share				
Continuing operations	$ 0.03	$ 0.01	$ 0.28	$ (0.04)
Discontinued operations	0.03	0.03	(0.07)	0.05
Cumulative effect of change in accounting method	—	—	—	(1.25)
Net income (loss)	$ 0.06	$ 0.04	$ 0.21	$ (1.24)
Weighted average number of common and common equivalent shares outstanding:				
Basic	17,834	18,426	17,751	18,294
Diluted	18,281	18,938	18,226	18,294

The accompanying condensed notes are an integral part of these consolidated financial statements.

CARRIAGE SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited and in thousands)

	For the nine months ended September 30, 2004	2005
Cash flows from operating activities:		
Net income (loss) from continuing operations	$ 5,089	$ (782)
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by (used in) continuing operating activities:		
Depreciation	5,273	5,126
Amortization	3,702	2,283
Provision for losses on accounts receivable	1,781	2,112
Net (gain) loss on sale of business assets	(963)	577
Stock-based compensation	374	512
Loss on early extinguishment of debt	—	978
Loss on sale of trust investments	235	—
Deferred income taxes	3,053	(483)
Other	502	11
Changes in assets and liabilities, net of effects from acquisitions and dispositions (Increase) in accounts receivable	(885)	(2,967)
(Increase) in inventories and other current assets	(718)	(1,814)
(Increase) in deferred charges and other	(198)	(779)
(Increase) in deferred obtaining costs	(3,455)	—
(Increase) in preneed trust investments	(869)	(3,708)
(Decrease) in accounts payable and accrued liabilities	(2,816)	(4,781)
Increase in deferred revenue	1,338	4,564
Increase (decrease) in deferred interest on convertible junior subordinated debenture	5,216	(10,345)
Net cash provided by (used in) operating activities of continuing operations	16,659	(9,496)
Net cash provided by operating activities of discontinued operations	514	62
Net cash provided by (used in) operating activities	17,173	(9,434)
Cash flows from investing activities:		
Acquisition	—	(1,285)
Net proceeds from sales of businesses and other assets	3,760	223
Purchase of short term investments	—	(20,851)
Maturities of short term investments	—	11,872
Capital expenditures	(3,387)	(5,487)
Net cash provided by (used in) investing activities of continuing operations	373	(15,528)
Net cash sales proceeds (purchases) of discontinued operations	(123)	1,571
Net cash provided by (used in) investing activities	250	(13,957)
Cash flows from financing activities:		
Net proceeds (payments) on bank line of credit	7,500	(25,600)
Proceeds from the issuance of senior notes	—	130,000
Payments on senior long-term debt and obligations under capital leases	(25,117)	(72,274)
Proceeds from issuance of common stock	279	312
Proceeds from the exercise of stock options	187	515
Payment of financing costs	—	(4,175)
Net cash provided by (used in) financing activities	(17,151)	28,778
Net increase in cash and cash equivalents	272	5,387
Cash and cash equivalents at beginning of period	2,024	1,948
Cash and cash equivalents at end of period	$ 2,296	$ 7,335

The accompanying condensed notes are an integral part of these consolidated financial statements.

CARRIAGE SERVICES, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) The Company

Carriage Services, Inc. (“Carriage” or the “Company”) is a leading provider of products and services in the death care industry in the United States. As of September 30, 2005, the Company owned and operated 135 funeral homes and 29 cemeteries in 28 states.

(b) Principles of Consolidation

The accompanying consolidated financial statements include the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated.

(c) Interim Condensed Disclosures

The information for the three and nine month periods ended September 30, 2004 and 2005 is unaudited, but in the opinion of management, reflects all adjustments which are normal, recurring and necessary for a fair presentation of financial position and results of operations for the interim periods. Certain information and footnote disclosures, normally included in annual financial statements, have been condensed or omitted. Except for Note 3, Change in Accounting for Preneed Selling Costs, the accompanying consolidated financial statements have been prepared consistent with the accounting policies described in our annual report on Form 10-K for the year ended December 31, 2004, and should be read in conjunction therewith. Certain amounts in the consolidated financial statements for the period ended in 2004 in this report have been reclassified to conform to current year presentation.

(d) Cash Equivalents

The Company considers all investments purchased with an original maturity of three months or less at the time of purchase to be cash equivalents.

(e) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Allowances from customer cancellations, refunds and bad debts are provided as a percentage of recognized revenue at the date the sale is recognized as revenue based on our historical experience. In addition, we monitor changes in delinquency rates and provide additional bad debt and cancellation reserves when warranted. Our methodologies and the resulting estimates have been reliable in past periods. We do not expect to change the factors and assumptions used in calculating these reserves in the future.

(f) Stock Plans and Stock Compensation

The Company has stock-based employee compensation plans in the form of stock option and employee stock purchase plans. The Company accounts for stock-based compensation under APB Opinion No. 25, “Accounting for Stock Issued to Employees” whereby no compensation expense is recognized in the Consolidated Statement of Operations and has adopted the disclosure-only provisions of SFAS No. 123, “Accounting for Stock-Based Compensation” and SFAS No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure.”

Had compensation cost for these plans been determined consistent with SFAS No. 123, “Accounting for Stock-Based Compensation”, net income and income per share would have been the following pro forma amounts (in thousands, except per share data):

	Three months ended September 30,		Nine months ended September 30,	
	2004	2005	2004	2005
Net income (loss) available to common stockholders:				
As reported	$ 1,157	$ 670	$ 3,751	$ (22,657)
Pro forma	$ 1,070	$ 560	$ 3,490	$ (22,987)
Net income (loss) per share available to common stockholders:				
Basic				
As reported	$ 0.07	$ 0.04	$ 0.21	$ (1.24)
Pro forma	$ 0.06	$ 0.03	$ 0.20	$ (1.26)
Diluted				
As reported	$ 0.06	$ 0.04	$ 0.21	$ (1.24)
Pro forma	$ 0.06	$ 0.03	$ 0.19	$ (1.26)

The Company issued 268,000 shares of restricted common stock to certain officers of the Company in the first quarter of 2005. Twenty-five percent of the shares vest annually on each of the next four anniversary dates of the grant. The value of the stock at the date of grant was $4.99 per share, for a total of $1,337,320, which is amortized into expense over the vesting period.

2. FUTURE ACCOUNTING CHANGES

Accounting Changes and Error Corrections

The Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting No. 154, “Accounting Changes and Error Corrections” (“FAS No. 154). This statement is a replacement of Accounting Principles Board Opinion No. 20 and FAS No. 3. FAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle and error corrections. It establishes, unless impracticable and absence of explicit transition requirements, retrospective application as the required method of a change in accounting principle to the newly adopted accounting principle. Also, it establishes guidance for reporting corrections of errors as reporting errors involves adjustments to previously issued financial statements similar to those generally applicable to reporting accounting changes retrospectively. FAS No. 154 also provides guidance for determining and reporting a change when retrospective application is impracticable. FAS No. 154 is effective for accounting changes and corrections of errors made in the fiscal years beginning after December 15, 2005. The Company will adopt the requirements beginning January 1, 2006.

Stock Related Compensation

In December 2004, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 123R, “Share-Based Payment” (“FAS No. 123R”). FAS No. 123R requires companies to recognize compensation expense in an amount equal to the fair value of the share-based payment (including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans) issued to employees. FAS No. 123R applies to all transactions involving issuance of equity by a company in exchange for goods and services, including employee services. FAS No. 123R is effective in the first annual reporting period of the first fiscal year beginning on or after June 15, 2005. The Company will adopt FAS No. 123R in the first fiscal quarter of its 2006 fiscal year and expects to use the modified prospective application method, which results in no restatement of the Company’s previously issued annual consolidated financial statements. The adoption of FAS No. 123R using the modified prospective application method is not expected to have a material impact on the consolidated financial position and no impact on cash flows of the Company. The future compensation expense will vary in the future due to changes in the inputs. Management currently estimates that the adoption of FAS No. 123R will reduce net income in 2006 within a range of $0.1 million to $0.2 million.

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3. CHANGE IN ACCOUNTING FOR PRENEED SELLING COSTS

On June 30, 2005, the Company changed its method of accounting for deferred obtaining costs, which are preneed selling costs, incurred for the origination of prearranged funeral and cemetery service and merchandise sales contracts. Prior to this change, commissions and other costs that were related to the origination of prearranged funeral and cemetery service and merchandise sales were deferred and amortized with the objective of recognizing the selling costs in the same period that the related revenue is recognized. Under the prior accounting method, the commissions and other direct selling costs, which are current obligations that are paid and use operating cash flow, are not recognized currently in the income statement. The Company believes it is preferable to expense the current obligation for the commissions and other costs rather than defer these costs. The Company also believes the new accounting method will improve the comparability of its reported earnings to the other deathcare companies. The Company has applied this change in accounting method effective January 1, 2005. Therefore, the Company's results of operations for the three and nine months ended September 30, 2005 are reported on the basis of our changed method.

As of January 1, 2005, the Company recorded a cumulative effect of change in accounting method of $35.8 million pretax or $22.8 million after tax (net of income tax benefit of $13.0 million), or $1.25 per diluted share, which represents the cumulative balance of deferred preneed selling costs in the Company's consolidated balance sheet. The table below presents the Company's income (loss) from continuing operations before cumulative effect of change in accounting method, net income (loss), diluted earnings (loss) per share from continuing operations before cumulative effect of change in accounting method and diluted net earnings (loss) per share for the three and nine months ended September 30, 2005 had the Company not made this accounting change (in thousands, except per share amounts).

	Three Months Ended September 30, 2005			Nine Months Ended September 30, 2005		
	As Reported	Effect of Change	Results under Prior Method	As Reported	Effect of Change	Results under Prior Method
Income (loss) from continuing operations before cumulative effect of change in accounting method	$ 140	$ 137	$ 277	$ (782)	$ 1,579	$ 797
Net income (loss)	670	69	739	(22,657)	23,646	989
Diluted earnings (loss) per common share from continuing operations before cumulative effect of change in accounting method	0.01	0.01	0.02	(0.04)	0.08	0.04
Diluted earnings (loss) per common share	0.04	0.00	0.04	(1.24)	1.29	0.05

The table below presents the pro forma amounts for the three and nine months ended September 30, 2004 as if the accounting change had been in effect during those periods (in thousands, except per share amounts).

	Three Months Ended September 30, 2004			Nine Months Ended September 30, 2004		
	As Previously Reported	Effect of Change	Proforma	As Previously Reported	Effect of Change	Proforma
Gross profit:						
Funeral	$ 6,101	$ (281)	$ 5,820	$ 21,942	$ (826)	$ 21,116
Cemetery	2,031	(542)	1,489	6,783	(1,580)	5,203
	$ 8,132	$ (823)	$ 7,309	$ 28,725	$ (2,406)	$ 26,319
Income from continuing operations	$ 489	$ (514)	$ (25)	$ 5,162	$ (1,504)	$ 3,658
Net income (loss)	1,157	(255)	902	3,751	(1,258)	2,493
Diluted earnings per common share from continuing operations	0.03	(0.03)	0.00	0.28	(0.08)	0.20
Diluted earnings (loss) per common share	0.06	(0.01)	0.05	0.21	(0.07)	0.14

4. ASSETS HELD FOR SALE

At June 30, 2005, two cemetery businesses were held for sale. During July 2005, the Company closed on the sale of one of the cemetery businesses. The sale transaction generated net cash proceeds totaling $1.1 million and a gain of approximately $0.8 million. Plans to sell the remaining cemetery were abandoned during the third quarter when the buyer decided against the transaction. We are operating this cemetery. The consolidated financial statements for the period ended in 2004 in this report have been reclassified to conform with current presentation. No businesses were held for sale at September 30, 2005.

The operating results of the businesses held for sale as well as the gain on the disposal are presented in the discontinued operations section of the consolidated statements of operations, along with the income tax effect on a comparative basis. Likewise, the operating results, the impairment charges and gains or losses from businesses sold in the prior year have been similarly reported for comparability. Revenues for the businesses presented in the discontinued operations section are as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2004	2005	2004	2005
Revenues, net	$ 423	$ 34	$ 1,986	$ 462

5. SHORT TERM INVESTMENTS

Short term investments are investments purchased with an original maturity of greater than three months at the time of purchase. Short term investments at September 30, 2005 consisted of commercial paper with maturity dates that range from October 2005 to January 2006 at rates ranging from 3.28 percent to 3.65 percent per anum. Market value approximates cost.

6. PRENEED ASSETS

Preneed assets consist of the following:

	December 31, 2004	September 30, 2005
Cemetery preneed receivables and trust investments	$ 65,855	$ 70,178
Funeral preneed receivables and trust investments	49,494	55,041
Receivable from funeral trusts	18,074	17,439
	$ 133,423	$ 142,658

Preneed cemetery receivables and trust investments

Preneed cemetery receivables and trust investments, net of allowance for cancellations, represent trust fund assets and customer receivables (net of unearned finance charges) for contracts sold in advance of when merchandise or services are needed. The components of *Preneed cemetery receivables and trust investments* in the consolidated balance sheet at September 30, 2005 are as follows (in thousands):

	September 30, 2005
Trust investments	$ 57,040
Receivables from customers, excluding current portion	17,155
Unearned finance charges, excluding current portion	(3,277)
Allowance for doubtful accounts, excluding current portion	(740)
Preneed cemetery receivables and trust investments	$ 70,178

Preneed cemetery receivables and trust investments are reduced by the trust investment earnings the Company has been allowed to withdraw prior to performance by the Company and amounts received from customers that are not required to be deposited into trust, pursuant to various state laws. Preneed cemetery sales are usually financed through interest-bearing installment sales contracts, generally with terms of up to five years. The interest rates generally range between 12 percent and 14 percent.

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The cost and market values associated with cemetery preneed trust investments at September 30, 2005 are detailed below (in thousands). The Company believes the unrealized losses related to trust investments at September 30, 2005 are temporary in nature. Net unrealized gains increased $1.1 and $1.3 million for the three and nine months ended September 30, 2005, respectively.

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash, money market and other short-term investments	$ 13,320	$ —	$ —	$ 13,320
Fixed income securities:				
U.S. Treasury	—	—	—	—
U.S. Agency obligations	5,074	3	(58)	5,019
State obligations	12,134	214	(144)	12,204
Corporate	3,173	62	(40)	3,195
Other	8	—	—	8
Common stock				
Mutual funds:				
Equity	13,180	3,424	(217)	16,387
Fixed income	5,853	559	(2)	6,410
Other investments	273	23	(3)	293
	$ 53,015	$ 4,285	$ (464)	$ 56,836
Accrued net investment income	$ 204			204
Trust investments				$ 57,040
Market value as a percentage of cost				107.6%

Preneed funeral receivables and trust investments

Preneed funeral receivables and trust investments, net of allowance for cancellations, represent trust fund assets and customer receivables related to contracts sold in advance of when the services or merchandise is needed. Such contracts are secured by funds paid by the customer to the Company. *Preneed funeral receivables and trust investments* are reduced by the trust investment earnings the Company has been allowed to withdraw prior to performance by the Company and amounts received from customers that are not required to be deposited into trust, pursuant to various state laws.

The components of *Preneed funeral receivables and trust investments* in the consolidated balance sheet at September 30, 2005 are as follows (in thousands):

	September 30, 2005
Trust investments	$ 52,519
Receivables from customers	8,951
Allowance for contract cancellations	(6,429)
Preneed funeral receivables and trust investments	$ 55,041

The cost and market values associated with funeral preneed trust investments at September 30, 2005 are detailed below (in thousands). The Company believes the unrealized losses related to trust investments at September 30, 2005 are temporary in nature. Net unrealized gains increased $0.2 and increased $0.4 million for the three and nine months ended September 30, 2005, respectively.

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash, money market and other short-term investments	$ 22,473	$ —	$ —	$ 22,473
Fixed income securities:				
U.S. Treasury	1,968	5	(15)	1,958
U.S. Agency obligations	1,769	85	—	1,854
State obligations	1,534	55	(8)	1,581
Other	1,043	7	(10)	1,040
Common stock				
Mutual funds:				
Equity	2,916	604	(92)	3,428
Fixed income	19,492	926	(233)	20,185
Trust investments	$ 51,195	$ 1,682	$ (358)	$ 52,519
Market value as a percentage of cost				102.6%

Receivable from Preneed Funeral Contracts

The receivable from funeral trusts at September 30, 2005 represent assets in trusts which are controlled and operated by third parties in which the Company does not have a controlling financial interest (less than 50%) in the trust assets. The Company accounts for these investments at cost.

Trust Investment Security Transactions

Investment security transactions recorded in Other income in the Consolidated Statement of Operations for the three and nine months ended September 30, 2004 and 2005 are as follows (in thousands).

	For the three months ended September 30,		For the nine months ended September 30,	
	2004	2005	2004	2005
Investment income	$ 1,068	$ 1,698	$ 1,955	$ 2,824
Realized gains	208	390	262	2,023
Realized losses	(359)	(35)	(654)	(484)
Expenses	(232)	(154)	(434)	(430)
Increase in non-controlling interests in trust investments	(685)	(1,899)	(1,129)	(3,933)
	$ —	$ —	$ —	$ —

7. CONTRACTS SECURED BY INSURANCE

Certain preneed funeral contracts are secured by life insurance contracts. The proceeds of the life insurance policies have been assigned to the Company and will be paid upon the death of the insured. The proceeds will be used to satisfy the beneficiary's obligations under the preneed contract for services and merchandise. The preneed funeral contracts secured by insurance which are not included in the Company's consolidated balance sheet totaled $186.8 million at September 30, 2005.

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8. CEMETERY PERPETUAL CARE TRUST INVESTMENTS

The Company is required by state law to pay a portion of the proceeds from the sale of cemetery property interment rights into perpetual care trust funds. The cost and market values associated with the trust investments held in perpetual care trust funds at September 30, 2005 are detailed below (in thousands). The Company believes the unrealized losses related to the trust investments at September 30, 2005 are temporary in nature.

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash, money market and other short-term investments	$ 3,106	$ —	$ 2	$ 3,108
Fixed income securities:				
U.S. Treasury	698	9	(8)	699
U.S. Agency obligation	7,352	11	(63)	7,300
State obligations	58	—	—	58
Corporate	2,431	92	(16)	2,507
Other	1,521	—	(4)	1,517
Common stock				
Mutual funds:				
Equity	9,635	1,421	(148)	10,908
Fixed income	5,987	376	(7)	6,356
Other assets	144	117	—	261
	$ 30,932	$ 2,026	$ (244)	$ 32,714
Accrued net investment income	$ 141			141
Trust investments				$ 32,855
Market value as a percentage of cost				106.2%

Non-controlling interests in cemetery perpetual care trusts represent the corpus of those trusts for which the Company is only entitled to receive the income. The components of *Non-controlling interests in cemetery perpetual care trusts* as of September 30, 2005 are as follows:

	Cemetery Perpetual Care
Trust assets, at market value	$ 32,855
Pending withdrawals of income	(229)
Debt due to a perpetual care trust	1,098
Pending deposits	2,311
Non-controlling interests	$ 36,035

9. DEFERRED REVENUE

Deferred revenue consists of the following:

	December 31, 2004	September 30, 2005
Deferred cemetery revenue	$ 46,787	$ 45,428
Deferred preneed funeral contracts revenue	30,973	29,631
Non-controlling interests in funeral and cemetery trust investments	98,652	109,559
	$ 176,412	$ 184,618

Non-controlling interests in funeral and cemetery preneed trusts represent deferred revenue related to assets held in the trusts. The Company will recognize the revenue at the time the service is performed and merchandise is delivered. The components of *Non-controlling interests in funeral and cemetery preneed trusts* as of September 30, 2005 are as follows:

	Non-controlling Interests		
	Preneed Funeral	Preneed Cemetery	Total Preneed
Trust assets, at market value	$ 52,519	$ 57,040	$ 109,559
Non-controlling interests	$ 52,519	$ 57,040	$ 109,559

10. MAJOR SEGMENTS OF BUSINESS

Carriage conducts funeral and cemetery operations only in the United States. The following table presents external revenue, pretax income from continuing operations and total assets by segment (in thousands):

	Funeral	Cemetery	Corporate	Consolidated
External revenues from continuing operations:				
Nine months ended September 30, 2005	$ 86,858	$ 29,722	$ —	$ 116,580
Nine months ended September 30, 2004	$ 85,054	$ 28,576	$ —	$ 113,630
Income (loss) from continuing operations before income taxes:				
Nine months ended September 30, 2005	$ 23,192	$ 5,129	$ (29,586)	$ (1,265)
Nine months ended September 30, 2004	$ 22,233	$ 6,151	$ (20,241)	$ 8,143
Total assets:				
September 30, 2005	$ 329,328	$ 191,393	$ 48,397	$ 569,118
December 31, 2004	$ 344,940	$ 205,230	$ 14,986	$ 565,156

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11. SUPPLEMENTAL DISCLOSURE OF STATEMENT OF OPERATIONS INFORMATION

	For the three months ended September 30, 2004	For the three months ended September 30, 2005	For the nine months ended September 30, 2004	For the nine months ended September 30, 2005
Revenues, net				
Goods				
Funeral	$ 11,590	$ 11,586	$ 37,329	$ 37,961
Cemetery	$ 6,577	$ 7,107	$ 20,863	$ 20,953
Total Goods	$ 18,167	$ 18,693	$ 58,192	$ 58,914
Services				
Funeral	$ 14,992	$ 15,017	$ 47,725	$ 48,897
Cemetery	$ 2,649	$ 2,748	$ 7,713	$ 8,769
Total Services	$ 17,641	$ 17,765	$ 55,438	$ 57,666
Total Net Revenues	$ 35,808	$ 36,458	$113,630	$116,580
Cost of revenues				
Goods				
Funeral	$ 11,170	$ 11,133	$ 34,921	$ 35,083
Cemetery	$ 5,126	$ 5,637	$ 15,781	$ 16,683
Total Goods	$ 16,296	$ 16,770	$ 50,702	$ 51,766
Services				
Funeral	$ 9,305	$ 9,373	$ 28,176	$ 28,585
Cemetery	$ 2,107	$ 2,410	$ 6,150	$ 7,332
Total Services	$ 11,412	$ 11,783	$ 34,326	$ 35,917
Total Cost of revenues	$ 27,708	$ 28,553	$ 85,028	$ 87,683

12. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

The following information is supplemental disclosure for the Consolidated Statement of Cash Flows (in thousands):

	For the nine months ended September 30, 2004	For the nine months ended September 30, 2005
Cash paid for interest and financing costs	$ 9,071	$ 31,226
Cash paid for income taxes (state)	$ 114	$ 270
Restricted common stock issued to officers	$ —	$ 1,337
Restricted cash investing and financing activities:		
Proceeds from the sale of securities of the funeral and cemetery trusts		$ 3,645
Purchase of available for sale securities of the funeral and cemetery trusts		$ 4,865
Net deposits in trust accounts increasing noncontrolling interests		$ 14,134

Amortization for the nine month periods ended September 30, 2004 and 2005 consists of the following (in thousands):

	September 30, 2004	September 30, 2005
Intangible assets	$ 413	$ 403
Loan origination fees	603	475
Preneed contract obtaining costs	1,042	—
Cemetery interment and entombment costs	1,644	1,405
	$ 3,702	$ 2,283

13. DEBT

At December 31, 2004, Carriage's senior debt included a $45 million unsecured revolving bank credit facility that was scheduled to mature in March 2006 and $70.5 million of Senior Notes to insurance companies due in 2006 and 2008. In January 2005, the Company issued $130 million of 7.875 percent Senior Notes at par, due in 2015. The proceeds from these notes were used to refinance substantially all senior debt, bring current the cumulative deferred distributions on the convertible junior subordinated debenture and the TIDES, and for general corporate purposes. In March 2005, the Company paid the cumulative deferred distributions on the TIDES totaling $10.9 million. During April 2005, the Company entered into a $35 million senior secured revolving credit facility that matures in five years to replace the existing unsecured credit facility. Borrowings under the new credit facility bear interest at prime or LIBOR options with the initial LIBOR option set at LIBOR plus 300 basis points and is collateralized by all personal property and funeral home real property in certain states. The facility is currently undrawn and $24 million is available to borrow at September 30, 2005.

Carriage, the parent entity, has no independent assets or operations. All assets and operations are held and conducted by subsidiaries, each of which (except for Carriage Services Capital Trust which is a single purpose entity that holds our debentures issued in connection with our TIDES) have fully and unconditionally guaranteed our obligations under the new Senior Notes. Additionally, we do not currently have any significant restrictions on our ability to receive dividends or loans from any subsidiary guarantor under the new Senior Notes.

In connection with the senior debt refinancing, the Company made a required "make whole" payment of $6.0 million in the form of additional interest and recorded a charge to write off $0.7 million of unamortized loan costs (in aggregate $4.2 million after tax, or $0.23 per diluted share) during the first quarter of 2005. In connection with the new senior secured revolving credit facility, the Company recorded a charge to write off $0.2 million or $0.01 per diluted share of unamortized loan costs during the second quarter. These charges are included in the Consolidated Statement of Operations as additional interest and other costs of senior debt refinancing for 2005.

14. OTHER (INCOME) EXPENSE

The following table describes the components of other (income) expense of the Company for the three and nine months ended September 30, 2004 and 2005 (amounts in thousands):

	Three months ended September 30, 2004		Three months ended September 30, 2005		Nine months ended September 30, 2004		Nine months ended September 30, 2005	
	Amount	Diluted EPS impact	Amount	Diluted EPS impact	Amount	Diluted EPS impact	Amount	Diluted EPS impact
Net (gains) loss from the disposition of business assets	$ (72)	$ —	$ 2	$ —	$ (963)	$ (0.03)	$ 576	$ 0.02
Write off of software development costs	495	0.02	—	—	495	0.02	—	—
Interest income	—	—	(142)	(0.01)	—	—	(327)	(0.01)
	$ 423	$ 0.02	$ (140)	$ (0.01)	$ (468)	$ (0.01)	$ 249	$ 0.01

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15. ACQUISITION

The Company acquired a funeral home business consisting of two funeral homes in northern Florida for $1.3 million cash during September 2005. The acquisition was accounted for as a purchase of the assets of the business. The assets were recorded at fair value and included goodwill in the amount of $0.4 million. The Company did not assume any liabilities of the business except for the obligation to perform funeral services with a value of approximately $4.1 million secured by a similar amount of trust funds.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

In addition to historical information, this Quarterly Report contains forward-looking statements within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements include any projections of earnings, revenues, asset sales, acquisitions, cash balances and cash flow, debt levels or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements regarding future economic conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing. Forward-looking statements may include the words "may", "will", "estimate", "intend", "believe", "expect", "project", "forecast", "plan", "anticipate" and other similar words.

Cautionary Statements

The Company cautions readers that the following important factors, among others, in some cases have affected, and in the future could affect, the Company's actual consolidated results and could cause the Company's actual consolidated results in the future to differ materially from the goals and expectations expressed herein and in any other forward-looking statements made by or on behalf of the Company. For further information regarding the Company's cautionary statements, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's annual report filed on Form 10-K for the year ended December 31, 2004.

Risks related to our business

(1) Marketing and sales activities by existing and new competitors could cause us to lose market share and lead to lower revenues and gross profit.

(2) Price competition could also reduce our market share or cause us to reduce prices to retain or recapture market share, either of which could reduce revenues and gross profit.

(3) Improved performance in our funeral segment is highly dependent upon successful execution of our standards-based Being the Best operating model.

(4) Our ability to generate preneed sales depends on a number of factors, including sales incentives and local and general economic conditions.

(5) Earnings from and principal of trust funds and insurance contracts could be reduced by changes in financial markets.

(6) Our ability to execute our growth strategy is highly dependent upon our ability to successfully identify suitable acquisition candidates and negotiate transactions on favorable terms.

(7) Our ability to successfully integrate acquisitions into the Company's business and to realize expected revenues and profits from the acquired businesses.

(8) Increased or unanticipated costs, such as insurance, taxes, new computer systems implementations and the cost of complying with Sarbanes-Oxley, may have a negative impact on our earnings and cash flows.

(9) Increases in interest rates would increase interest costs when we borrow against our variable-rate bank credit facility and could have a material adverse effect on our net income.

(10) Covenant restrictions under our debt instruments may limit our flexibility in operating our business.

Risks related to the death care industry

(1) Declines in the number of deaths in our markets can cause a decrease in revenues and gross profit. Changes in the number of deaths are not predictable from market to market or over the short term.

(2) The increasing number of cremations in the United States could cause revenues to decline because we could lose market share to firms specializing in cremations. In addition, direct cremations produce no revenues for cemetery operations and lower funeral revenues.

(3) If we are not able to respond effectively to changing consumer preferences, our market share, revenues and profitability could decrease.

(4) Because the funeral and cemetery businesses are primarily fixed-cost businesses, changes in revenues can have a disproportionately large effect on cash flow and profits.

(5) Changes or increases in, or failure to comply with, regulations applicable to our business could increase costs or decrease cash flows.

OVERVIEW

We operate two types of businesses: funeral homes, which account for approximately 75% of our revenues, and cemeteries, which account for approximately 25% of our revenues. Funeral homes are principally a service business that provide funeral services (burial and cremation) and sell related merchandise, such as caskets and urns. Cemeteries are primarily a sales business that sells interment rights (grave sites and mausoleums) and related merchandise such as markers and memorials. As of September 30, 2005, we operated 135 funeral homes and 29 cemeteries in 28 states within the United States. Substantially all administrative activities are conducted in our home office in Houston, Texas.

Factors affecting our funeral operating results include: demographic trends in terms of population growth and average age, which impact death rates and number of deaths; establishing and maintaining leading market share positions supported by strong local heritage and relationships; effectively responding to increasing cremation trends by packaging complementary services and merchandise; controlling salary and merchandise costs; and exercising pricing leverage related to our at-need business to increase average revenues per contract. In simple terms, volume and price are the two variables that affect funeral revenues. The average revenue per contract is influenced by the mix of traditional and cremation services because our average cremation service revenue is approximately 35% of the average revenue earned from a traditional burial service. Funeral homes have a relatively fixed cost structure. Thus small changes in revenues, up or down, normally cause significant changes to our profitability.

We have implemented several significant long-term initiatives in our funeral operations designed to improve operating and financial results by growing market share and increasing profitability. During the fall of 2003, we introduced a more decentralized, entrepreneurial and local operating model. At the same time, we introduced operating and financial standards developed from our best funeral operations, along with an incentive compensation plan to reward business managers for successfully meeting or exceeding the standards. The operating model and standards, which we refer to as “Being the Best,” focus on the key drivers of a successful funeral operation, organized around three primary areas – market share, people and operating and financial metrics. The model and standards are the measures by which we judge the success of each funeral business.

The cemetery operating results are affected by the size and success of our sales organization because approximately 55% of our cemetery revenues for the nine months ended September 30, 2005 relate to sales of grave sites and mausoleums and related merchandise and services before the time of need. We believe that changes in the level of consumer confidence (a measure of whether consumers will spend for discretionary items) also affects the amount of cemetery revenues. Approximately 10% of our cemetery revenues for the nine months ended September 30, 2005 are attributable to investment earnings on trust funds and finance charges on installment contracts. Changes in the capital markets and interest rates affect this component of our cemetery revenues.

Net income from continuing operations for the three months ending September 30, 2005 totaled $0.1 million, equal to $0.01 per diluted share as compared to net income from continuing operations of $0.5 million for the third quarter of 2004, or $0.03 per diluted share.

The following items affected the comparability of income from continuing operations for the third quarter (in thousands, except per share amounts):

	Amount, net of Income Tax	Earnings per Share
Income from continuing operations for the three months ended September 30, 2004	$ 471	$ 0.03
Decrease in gross profit from funeral and cemetery operations (including the change in accounting for preneed selling costs)	(124)	(0.01)
Change in other income (expense) from 2004 to 2005	358	0.02
Higher interest expense	(316)	(0.02)
Higher general and administrative expenses in 2005, primarily to document and evaluate internal controls and upgrade systems and processes	(249)	(0.01)
Income from continuing operations for the three months ended September 30, 2005	$ 140	$ 0.01

Net loss from continuing operations for the first nine months of 2005 totaled $0.8 million, equal to ($0.04) per share as compared to net income from continuing operations of $5.1 million for the first nine months of 2004, or $0.28 per diluted share. The variance between the two periods was primarily due to a make-whole payment during the first quarter of 2005 to the former debtholders in connection with the repayment of the previously outstanding senior debt. We repaid this senior debt and paid the make-whole payment with proceeds from our $130 million senior note offering, which closed in January 2005. The make-whole payment resulted in additional pre-tax interest of $6.0 million, along with a charge in the amount of $0.7 million to write off the related unamortized loan costs, in total equal to $0.23 per diluted share. Additionally, the change in accounting for preneed selling costs in 2005 reduced net income from continuing operations by $1.0 million, equal to $0.05 per diluted share. Excluding the effect of these items, diluted earnings per share from continuing operations for the nine months ending September 30, 2005 equaled $0.24 compared to the prior year nine months ended September 30, 2004 of $0.28.

Income from discontinued operations for the nine months ending September 30, 2005 totaled $0.9 million, equal to $0.05 per diluted share, and consisted primarily of a gain on the sale of a funeral home business during the first quarter and the sale of a cemetery business in the third quarter. Loss from discontinued operations for the nine months ending September 30, 2004 totaled $1.3 million, equal to ($0.07) per share, and consisted primarily of impairment charges for businesses sold in the second half of 2004.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of the consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, we evaluate estimates and judgments, including those related to revenue recognition, realization of accounts receivable, intangible assets, property and equipment and deferred tax assets. We base our estimates on historical experience, third party data and assumptions that we believe to be reasonable under the circumstances. The results of these considerations form the basis for making judgments about the amount and timing of revenues and expenses, the carrying value of assets and the recorded amounts of liabilities. Actual results may differ from these estimates and such estimates may change if the underlying conditions or assumptions change. Historical performance should not be viewed as indicative of future performance, as there can be no assurance the margins, operating income and net earnings as a percentage of revenues will be sustained consistently from year to year.

Management's discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements presented herewith, which have been prepared in accordance with U.S. generally accepted accounting principles. Our significant accounting policies are more fully described in Note 1 to the Consolidated Financial Statements included in our annual report on Form 10-K for the year ended December 31, 2004. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Funeral and Cemetery Operations

We record the sales of funeral merchandise and services when the funeral service is performed. Sales of cemetery interment rights are recorded as revenue in accordance with the retail land sales provisions of Statement of Financial Accounting Standards (SFAS) No 66., “Accounting for Sales of Real Estate.” This method provides for the recognition of revenue in the period in which the customer’s cumulative payments exceed 10% of the contract price related to the real estate. Costs related to the sales of interment rights, which include property and other costs related to cemetery development activities, are charged to operations using the specific identification method in the period in which the sale of the interment right is recognized as revenue. Revenue from the sales of cemetery merchandise and services are recognized in the period in which the merchandise is delivered or the service is performed. Revenues to be recognized from the delivery of merchandise and performance of services related to contracts that were acquired in acquisitions are typically lower than those originated by the Company and are likely to exceed the cash collected from the contract and received from the trust at maturity. We began expensing preneed selling costs as incurred in 2005 (see Accounting Change).

Allowances for customer cancellations, refunds and bad debts are provided at the date that the sale is recognized as revenue based on our historical experience. In addition, we monitor changes in delinquency rates and provide additional bad debt and cancellation reserves when warranted. When preneed funeral services and merchandise are funded through third-party insurance policies, we earn a commission from the sale of the policies. Insurance commissions are recognized as revenues when the commission is no longer subject to refund, which is usually one year after the policy is issued.

Allowances from customer cancellations, refunds and bad debts are provided as a percentage of recognized revenue at the date the sale is recognized as revenue based on our historical experience. In addition, we monitor changes in delinquency rates and provide additional bad debt and cancellation reserves when warranted. Our methodologies and the resulting estimates have been reliable in past periods. We do not expect to change the factors and assumptions used in calculating these reserves in the future.

Goodwill and Other Intangible Assets

The excess of the purchase price over the fair value of net identifiable assets acquired, as determined by management in transactions accounted for as purchases, is recorded as goodwill. Many of the acquired funeral homes have provided high quality service to families for generations. The resulting loyalty often represents a substantial portion of the value of a funeral business. Goodwill is typically not associated with or recorded for the cemetery businesses. In accordance with SFAS No. 142, we review the carrying value of goodwill at least annually on reporting units (aggregated geographically) to determine if facts and circumstances exist which would suggest that this intangible asset might be carried in excess of fair value. Fair value is determined by discounting the estimated future cash flows of the businesses in each reporting unit at the Company’s weighted average cost of capital less debt allocable to the reporting unit and by reference to recent sales transactions of similar businesses. The calculation of fair value can vary dramatically with changes in estimates of the number of future services performed, inflation in costs, and the Company’s cost of capital, which is impacted by long-term interest rates. If impairment is indicated, then an adjustment will be made to reduce the carrying amount of goodwill to fair value.

Income Taxes

The Company and its subsidiaries file a consolidated U.S. federal income tax return and separate income tax returns in the states in which we operate. We record deferred taxes for temporary differences between the tax basis and financial reporting basis of assets and liabilities, in accordance with SFAS 109, “Accounting for Income Taxes.” The Company records a valuation allowance to reflect the estimated amount of deferred tax assets for which realization is uncertain. Management reviews the valuation allowance at the end of each quarter and makes adjustments if it is determined that it is more likely than not that the tax benefits will be realized.

Stock Compensation Plans

The Company has four stock incentive plans under which stock options have been issued. Additionally, the Company sponsors an Employee Stock Purchase Plan (ESPP) under which employees can purchase common stock at a discount. The stock options are granted with an exercise price equal to or greater than the fair market value of the Company’s Common Stock. Substantially all of the options granted under the four stock option plans have ten-year terms. The options generally vest over a period of two to four years. The Company accounts for stock options and shares issued under the ESPP under APB Opinion No. 25, under which no compensation cost is recognized in the Consolidated Statement of Operations and has adopted the disclosure-only provisions of SFAS No. 123, “Accounting for Stock-Based Compensation” and SFAS No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure.” Had the Company accounted for stock options and shares pursuant to its employee stock benefit plans under SFAS No. 123 for the three months ended September 30, 2004 and 2005, net income for those periods would have been lower by approximately $0.01 for each period.

In December 2004, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 123R, “Share-Based Payment” (“FAS No. 123R”). FAS No. 123R requires companies to recognize compensation expense in an amount equal to the fair value of the share-based payment (including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans) issued to employees. FAS No. 123R applies to all transactions involving issuance of equity by a company in exchange for goods and services, including employee services. FAS No. 123R is effective in the first annual reporting period of the first fiscal year beginning on or after June 15, 2005. The Company will adopt FAS No. 123R in the first fiscal quarter of its 2006 fiscal year and expects to use the modified prospective application method, which results in no restatement of the Company's previously issued annual consolidated financial statements. The adoption of FAS No. 123R using the modified prospective application method is not expected to have a material impact on the consolidated financial position and will have no effect on cash flows of the Company. The adoption of FAS 123R is estimated to reduce earnings in 2006 by approximately $0.01 per diluted share.

Impairment of Long-Lived Assets

Except as noted for Goodwill, the Company reviews its long-lived assets for impairment when changes in circumstances indicate that the carrying amount of the net asset may not be recoverable in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Assets to be disposed of and assets not expected to provide any future service potential to the Company are recorded at the lower of carrying amount or fair value less estimated cost to sell. The revenues and expenses, as well as gains, losses and impairments, from those assets are reported in the discontinued operations section of the Consolidated Statement of Operations for all periods presented.

Variable Interest Entities

The Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46, as revised, ("FIN 46R"), *"Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin (ARB) No. 51."* This interpretation clarifies the circumstances in which certain entities that do not have equity investors with a controlling financial interest must be consolidated by its sponsor. The Company implemented FIN 46R as of March 31, 2004, which resulted, for financial reporting purposes, in the consolidation of the Company's preneed and perpetual care trust funds. The investments of such trust funds have been reported at market value and the Company's future obligations to deliver merchandise and services have been reported at estimated settlement amounts. The Company has also recognized the non-controlling financial interests of third parties in the trust funds. There was no cumulative effect of an accounting change recognized by the Company as a result of the implementation of FIN 46R. The implementation of FIN 46R affected certain accounts on the Company's balance sheet beginning March 31, 2004 as described below; however, it does not affect cash flow, net income or the manner in which we recognize and report revenues.

Although FIN 46R requires consolidation of preneed and perpetual care trusts, it does not change the legal relationships among the trusts, the Company and its customers. In the case of preneed trusts, the customers are the legal beneficiaries. In the case of perpetual care trusts, the Company does not have a right to access the corpus in the perpetual care trusts. For these reasons, the Company has recognized non-controlling interests in our financial statements to reflect third party interests in these consolidated trust funds.

Both the preneed trusts and the cemetery perpetual care trusts hold investments in marketable securities which have been classified as available-for-sale. The investments are reported at fair value, with unrealized gains and losses allocated to Non-controlling interests in trust investment in the Company's consolidated balance sheet. Unrealized gains and losses attributable to the Company, but that have not been earned through the performance of services or delivery of merchandise, are allocated to deferred revenues.

Also beginning March 31, 2004, the Company began recognizing income, gains and losses, of the preneed trusts and cemetery perpetual care trusts. The Company recognizes a corresponding expense equal to the recognized earnings of these trusts attributable to the non-controlling interest holders. When such earnings attributable to the Company have not been earned through the performance of services or delivery of merchandise, the Company will record such earnings as deferred revenue.

For preneed trusts, the Company recognizes as revenues amounts attributed to the non-controlling interest holders and the Company, including accumulated earnings, when the contracted services have been performed and merchandise delivered. For cemetery perpetual care trusts, the Company recognizes investment earnings in cemetery revenues when such earnings are realized and distributable. Such earnings are intended to defray cemetery maintenance costs incurred by the Company.

ACCOUNTING CHANGE

Preneed Selling Costs

On June 30, 2005, the Company changed its method of accounting for deferred obtaining costs, which are preneed selling costs incurred, for the origination of prearranged funeral and cemetery service and merchandise sales contracts. Prior to this change, commissions and other direct selling costs related to originating preneed funeral and cemetery service and merchandise sales contracts were deferred and amortized with the objective of recognizing the selling costs in the same period that the related revenue is recognized. Under the prior accounting method, the commissions and other direct selling costs, which are current obligations are paid and use operating cash flow, are not recognized currently in the income statement. The Company believes it is preferable to expense the current obligation for the commissions and other costs rather than defer these costs. The Company also believes the new accounting method will improve the comparability of its reported earnings. Because the three largest public deathcare companies now expense selling costs (two of which changed in 2005), investors and other users of the financial information will now be able to more easily compare our financial results to those deathcare companies.

The Company has applied this change in accounting method effective January 1, 2005. As of January 1, 2005, the Company recorded a cumulative effect of change in accounting method of $35.8 million pretax or $22.8 million after tax (net of income tax benefit of $13.0 million), or $1.25 per diluted share, which represents the cumulative balance of deferred preneed selling costs in the Company's consolidated balance sheet. Therefore, the Company's results of operations for the three and nine months ended September 30, 2005 are reported on the basis of our changed method. The annual impact on earnings per diluted share is approximately $0.10. The change has no effect on cash flow from operations. Refer to Note 3 for the change in accounting method for preneed selling costs and comparison of results as reported in this quarterly report and under the previous method.

RESULTS OF OPERATIONS

The following is a discussion of the Company's results of operations for the three and nine month periods ended September 30, 2004 and 2005. Funeral homes and cemeteries owned and operated for the entirety of each period being compared are referred to as "same-store" or "existing operations."

Funeral Home Segment. The following table sets forth certain information regarding the net revenues and gross profit of the Company from the funeral home operations for the three and nine months ended September 30, 2004 compared to the three and nine months ended September 30, 2005. For purposes of our discussion, the revenue and gross profit of our businesses identified to be sold are included in the same-store classification up to the quarter prior to their sale.

Three months ended September 30, 2004 compared to three months ended September 30, 2005 (dollars in thousands):

	Three Months Ended September 30,		Change	
	2004	2005	Amount	Percent
Total same-store revenue	$ 26,190	$ 25,945	$ (245)	(0.9%)
Acquired	—	45	45	*
Preneed insurance commissions revenue	392	613	221	56.0%
Revenues from continuing operations	$ 26,582	$ 26,603	$ 21	*
Revenues from discontinued operations	$ 264	$ —	$ (264)	*
Total same-store gross profit	$ 5,715	$ 5,466	$ (249)	(4.4%)
Acquired	—	18	18	*
Preneed insurance commissions revenue	392	613	221	56.0%
Gross profit from continuing operations	$ 6,107	$ 6,097	$ (10)	*
Gross profit from discontinued operations	$ 19	$ 2	$ (17)	*

* not meaningful

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Nine months ended September 30, 2004 compared to nine months ended September 30, 2005 (dollars in thousands):

	Nine Months Ended September 30,		Change	
	2004	2005	Amount	Percent
Total same-store revenue	$ 84,019	$ 85,159	$ 1,140	1.4%
Acquired	—	45	45	*
Preneed insurance commissions revenue	1,035	1,654	619	60.0%
Revenues from continuing operations	$ 85,054	$ 86,858	$ 1,804	2.1%
Revenues from discontinued operations	$ 1,474	$ 19	$ (1,455)	*
Total same-store gross profit	$ 20,922	$ 21,518	$ 596	2.8%
Acquired	—	18	18	*
Preneed insurance commissions revenue	1,035	1,654	619	60.0%
Gross profit from continuing operations	$ 21,957	$ 23,190	$ 1,233	5.6%
Gross profit from discontinued operations	$ 265	$ (23)	$ (288)	*

* not meaningful

Funeral same-store revenues for the three months ended September 30, 2005 decreased 0.9 percent when compared to the three months ended September 30, 2004, as we experienced a decrease of 0.5 percent in the number of contracts and a decrease of 0.4 percent to $5,309 in the average revenue per contract for those existing operations. Cremation services represented 33.3 percent of the number of funeral services during the third quarter of 2005, an increase from 31.0 percent in the third quarter of 2004. The average revenue for burial contracts increased 2.7 percent to $6,726, while the average revenue for cremation contracts decreased 0.4 percent to $2,389. The increase in cremations had the effect of reducing revenues by $0.5 million and reducing the average revenue per contract by $98.

Total funeral same-store gross profit for the three months ended September 30, 2005 decreased $0.2 million from the comparable three months of 2004, and as a percentage of funeral same-store revenue, declined from 21.8 percent to 21.1% primarily because of higher bad debts, repairs to funeral facilities and the change in accounting for preneed selling costs.

Funeral same-store revenues for the nine months ended September 30, 2005 increased 1.4 percent when compared to the nine months ended September 30, 2004, as we experienced a 0.1 percent decline in the number of contracts and an increase of 1.5 percent to $4,961 in the average revenue per contract for those existing operations. Cremation services represented 32.9 percent of the number of funeral services during the nine months ended September 30, 2005 compared to 31.2 percent for the nine months ended September 30, 2004. The average revenue for burial contracts increased 3.3 percent to $6,739, while the average revenue for cremation contracts increased 1.7 percent to $2,408. Preneed insurance commission revenue, which is generally recognized as revenue one year after origination, increased year over year because of an increasing emphasis on selling insurance related products and additions to our sales leadership during the previous two years.

Total funeral same-store gross profit for the nine months ended September 30, 2005 increased $0.6 million from the comparable nine months of 2004, and as a percentage of funeral same-store revenue, increased from 24.9 percent to 25.3 percent. The change in accounting method for preneed selling costs previously discussed was implemented prospectively as of January 1, 2005. We did not restate the results for 2004. The effect of that change was to reduce gross profit by $0.2 million for the nine month period ended September 30, 2005. Had we applied the new accounting method in 2004, funeral same-store gross profit would have increased by $1.4 million, or 6.9 percent from 2004 to 2005. We achieved positive operating leverage because of better execution of our new standards-based operating model.

Cemetery Segment. The following table sets forth certain information regarding the net revenues and gross profit of the Company from the cemetery operations for the three and nine months ended September 30, 2004 compared to the three and nine months ended September 30, 2005:

Three months ended September 30, 2004 compared to the three months ended September 30, 2005 (dollars in thousands)

	Three Months Ended September 30,		Change	
	2004	2005	Amount	Percent
Revenues from continuing operations	$ 9,226	$ 9,855	$ 629	6.8%
Revenues from discontinued operations	$ 159	$ 34	$ (125)	*
Gross profit from continuing operations	$ 1,993	$ 1,808	$ (185)	9.3%
Gross profit from discontinued operations	$ 39	$ 1	$ (38)	*

* not meaningful

Nine months ended September 30, 2004 compared to the nine months ended September 30, 2005 (dollars in thousands)

	Nine Months Ended September 30,		Change	
	2004	2005	Amount	Percent
Revenues from continuing operations	$ 28,576	$ 29,722	$ 1,146	4.0%
Revenues from discontinued operations	$ 512	$ 443	$ (69)	*
Gross profit from continuing operations	$ 6,645	$ 5,707	$ (938)	14.1%
Gross profit from discontinued operations	$ 139	$ 124	$ (15)	*

* not meaningful

Cemetery revenues from continuing operations for the three months ended September 30, 2005 increased 0.6 million compared to the three months ended September 30, 2004. Preneed property revenues increased $0.5 million because we recognized $0.5 million from the completion of mausoleums in the current year period. The average value of interment rights sold during the quarter increased 7.9 percent to $1,972 while the number of interment rights sold declined 11.0 percent. The number of interments performed decreased 10.9 percent and, consequently, our at-need revenues declined by $0.4 million. Deliveries of preneed merchandise and services increased $0.4 million year over year. Financial revenues (trust earnings and finance charges on installment contracts) totaled approximately $750,000; the same as the third quarter of the prior year.

Cemetery gross profit from continuing operations for the three months ended September 30, 2005 decreased $0.2 million from the comparable three months of 2004 and as a percentage of revenues decreased from 21.6 percent to 18.3 percent. The accounting change for preneed selling costs reduced gross profit by $0.2 million in the current year quarter.

Cemetery revenues from continuing operations for the nine months ended September 30, 2005 increased $1.1 million, or 4.0 percent, compared to the nine months ended September 30, 2004 substantially because of higher deliveries of merchandise and services. The number of preneed contracts written in the nine months ended September 30, of 2005 declined 4.5 percent to 6,485 compared to the same period in 2004. Average revenue per preneed contract written during the nine months ended September 30, 2005 increased 8.9 percent to $2,862 compared to the nine months ended September 30, 2004. Financial revenues (trust earnings and finance charges on installment contracts) totaled approximately $3.0 million, approximately $0.9 million higher than the prior year.

Cemetery gross profit from continuing operations for the nine months ended September 30, 2005 decreased $0.9 million and as a percentage of revenues decreased from 23.3 percent to 19.2 percent from the comparable nine months of 2004. The accounting change for preneed selling costs reduced profitability $1.4 million for the nine months ended September 30, 2005.

Other. General and administrative expenses, for the three and nine months ended September 30, 2005 increased $0.4 and $0.9 million or approximately 14.3 and 11.9 percent, respectively, as compared to the same periods of 2004 primarily because the 2005 period included higher audit and professional fees related to our on-going effort to comply with the internal control reporting requirements of Sarbanes-Oxley, upgrading systems and processes and the relocation of our home office. Such costs are expected to result in higher general and administrative expenses during the remainder of 2005.

Interest expense for the three and nine month periods ended September 30, 2005 increased $0.5 and $1.1 million, or 12.1 and 8.5 percent, compared to the same periods ended September 30, 2004 because the total debt increased when the Company refinanced its senior debt earlier in 2005. Additionally, the current year expense is negatively impacted by higher loan fees.

Income Taxes. The Company provided income taxes at the expected effective annual rate of 37.5 percent for continuing operations for the three and nine months ended September 30, 2004 and 36.7 percent and 38.2 percent for continuing operations for the three and nine months ended September 30, 2005, respectively. The tax benefit for the change in accounting method was recorded at the rate of 36.5 percent.

The Company has net operating loss carryforwards totaling approximately $14.3 million for Federal income tax purposes, as well as significant operating loss carryforwards in certain states. Because of the ability to use the net operating loss to offset taxable income and the timing of when revenue and expenses are recognized for tax purposes, we do not expect to pay Federal income taxes in 2005.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents totaled $7.3 million at September 30, 2005, representing an increase of $5.4 million from December 31, 2004. Short-term investments totaled $9.0 at September 30, 2005, compared to none in the prior year. For the nine months ended September 30, 2005, cash used by operating activities was $9.4 million as compared to cash provided of $17.2 million for the nine months ended September 30, 2004. Cash used by operating activities during 2005 included the $6.0 million make-whole payment and the payment of the previously deferred interest on the convertible junior subordinated debenture in the amount of $10.3 million. Additionally, increases in accounts receivable, preneed trust funds and other assets used $8.5 million of cash. Investing activities included $1.3 million for the acquisition of a funeral business in Florida, the first acquisition in over three years. Net cash provided by financing activities during 2005 totaled $28.8 million and was attributable to our senior debt refinancing.

In January 2005, the Company issued $130 million of 7.875 percent Senior Notes at par, due in 2015. The proceeds from these notes were used to refinance all then outstanding senior debt, including payments for accrued interest and make-whole payment, bring current the cumulative deferred distributions on the convertible junior subordinated debenture and the TIDES, and for general corporate purposes. The refinancing improved the Company's liquidity because debt totaling approximately $96 million due in 2006 and 2008 was replaced by debt maturing in ten years.

The Company's senior debt at September 30, 2005 totaled $142.4 million and consisted of the $130.0 million in Senior Notes, a $35 million revolving line of credit (none of which was outstanding at the time) and $12.4 million in acquisition indebtedness and capital lease obligations. Additionally, $0.7 million in letters of credit have been issued from the credit facility and are outstanding at September 30, 2005.

The Company's convertible junior subordinated debenture at September 30, 2005 total $93.75 million in principal amount, are payable to the Company's affiliate trust, Carriage Services Capital Trust, bear interest at 7 percent and mature in 2029. Substantially all the assets of the Trust consist of the convertible junior subordinated debenture of the Company. The Trust issued 1.875 million shares of convertible preferred term income deferrable equity securities (TIDES). The rights of the debenture are functionally equivalent to those of the TIDES.

The convertible junior subordinated debenture payable to the affiliated trust and the TIDES each contain a provision for the deferral of interest payments and distributions for up to 20 consecutive quarters. During the period in which distribution payments are deferred, distributions continue to accumulate at the 7 percent annual rate. Also, the deferred distributions themselves accumulate distributions at the annual rate of 7 percent and are recorded as a liability. During the deferral period, Carriage is prohibited from paying dividends on the common stock or repurchasing its common stock, subject to limited exceptions. The Company, in complying with the conditions of the existing credit facility, began deferring interest payments on the subordinated debenture payable to the Company's affiliated trust beginning with the September 1, 2003 payment. In the first quarter of 2005, the Company paid $10.3 million to bring the cumulative deferred distributions on the TIDES current. The Company expects to continue paying the distributions as due.

In April 2005, the Company entered into a $35 million senior secured revolving credit facility to replace the existing unsecured credit facility. Borrowings under the new credit facility bear interest at prime or LIBOR options with the initial LIBOR option set at LIBOR plus 300 basis points, matures in five years and is collateralized by all personal property and funeral home real property in certain states. The facility is currently undrawn and no borrowings are anticipated during 2005. $24.0 million is available to borrow at September 30, 2005.

The Company intends to use cash flow provided by operations, net of investments in property, plant and equipment, to acquire funeral home and cemetery businesses. The Company does not intend to draw on its revolving credit facility to finance acquisitions.

SEASONALITY

The Company's business can be affected by seasonal fluctuations in the death rate. Generally, the rate is higher during the winter months because the incidences of deaths from influenza and pneumonia are higher during this period than other periods of the year.

INFLATION

Inflation has not had a significant impact on the results of operations of the Company.

Item 3. Quantitative and Qualitative Disclosures of Market Risk

Carriage is currently exposed to market risk primarily related to changes in interest rates related to the Company's variable rate bank credit facility and changes in the values of securities associated with the preneed and perpetual care trusts. For information regarding the Company's exposure to certain market risks, see Item 7A. "Quantitative and Qualitative Market Risk Disclosure" in the Company's 2004 annual report filed on Form 10-K for the year ended December 31, 2004. There have been no significant changes in the Company's market risk from that disclosed in the Form 10-K for the year ended December 31, 2004.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this report. Based on their evaluation, our chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective at the end of the period. During the period covered by this report, there were no changes in our internal control over financial reporting, as such term is defined under Rule 13a-15(f) of the Exchange Act, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Based on the value of the Company's common stock held by non-affiliates on June 30, 2005, Carriage will be an accelerated filer for the year ending December 31, 2005. As an accelerated filer, in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, for the year ending December 31, 2005, we will perform a review of our internal control over financial reporting, and our internal control over financial reporting will be audited by our independent accountant. In order to comply with the Act, we are currently undergoing a comprehensive effort to document, verify and test key internal controls. During the documentation and verification phases, which are still underway, we have identified certain internal control issues which management concluded should be improved. However, to date we have not identified any material weaknesses in our internal controls as defined by the Public Company Accounting Oversight Board. Nonetheless, we are making improvements to our internal controls by revising or updating policies and procedures; training field personnel on procedures and best practices; improving segregation of duties when possible; enhancing information technology systems controls; and improving preventative controls. In particular, we are implementing a cemetery accounting and trusting system. In connection with the implementation of this system, we are converting data from the legacy systems to the new systems and reconciling reported balances. If additional internal control issues are identified by our continuing documentation and verification efforts, management will address those matters in a timely manner.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

Carriage and our subsidiaries are parties to a number of legal proceedings that arise from time to time in the ordinary course of business. While the outcome of these proceedings cannot be predicted with certainty, we do not expect these matters to have a material adverse effect on the financial statements.

We carry insurance with coverage and coverage limits consistent with our assessment of risks in our business and of an acceptable level of financial exposure. Although there can be no assurance that such insurance will be sufficient to mitigate all damages, claims or contingencies, we believe that our insurance provides reasonable coverage for known asserted or unasserted claims. In the event the Company sustained a loss from a claim and the insurance carrier disputed coverage or coverage limits, the Company may record a charge in a different period than the recovery, if any, from the insurance carrier.

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

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Issuance of Unregistered Securities

Carriage has a compensation policy for fees paid to its directors under which our directors may choose to receive director compensation fees either in the form of cash compensation or equity compensation based on the fair market value of our common stock based on the closing price published by the New York Stock Exchange on the date the fees are earned. The Company issued 3,101 and 1,667 shares of common stock to directors with a value of approximately $14,500 and $10,600 in lieu of payment in cash for their fees for the third quarter of 2004 and 2005, respectively. The Company issued 9,351 and 6,800 shares of common stock to directors with a value of $45,500 and $40,000 for the nine months ended September 30, 2004 and 2005, respectively. No underwriter was used in connection with this issuance. Carriage relied on the Section 4(2) exemption from the registration requirements of the Securities Act of 1933, as amended.

Item 3. Defaults Upon Senior Securities

None

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

None.

Item 5. Other Information

The Company reported on Form 8-K during the quarter covered by this report all information required to be reported on such form.

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Item 6. Exhibits

4.1 — Amendment No. 1 to the Credit Agreement dated April 27, 2005 among Carriage Services, Inc., as the Borrower, Bank of America, N.A. as the Administrative Agent, Swing Line Lender and L/C Issuer, Wells Fargo Bank of Texas, National Association, as Syndication Agent and Other Lenders

11.1 — Computation of Per Share Earnings

31.1 — Certification of Periodic Financial Reports by Melvin C. Payne in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002

31.2 — Certification of Periodic Financial Reports by Joseph Saporito in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002

32.1 — Certification of Periodic Financial Reports by Melvin C. Payne in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002 and 18 U.S.C. Section 1350

32.2 — Certification of Periodic Financial Reports by Joseph Saporito in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002 and 18 U.S.C. Section 1350

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SIGNATURE

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.

CARRIAGE SERVICES, INC.

November 11, 2005	/s/ Joseph Saporito
Date	Joseph Saporito, Executive Vice President, Chief Financial Officer and Secretary (Principal Financial Officer and Accounting Officer)

CARRIAGE SERVICES, INC.

INDEX OF EXHIBITS

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EXHIBIT 4.1

FIRST AMENDMENT TO CREDIT AGREEMENT

THIS FIRST AMENDMENT TO CREDIT AGREEMENT (this "First Amendment"), dated as of August 31, 2005, is by and among CARRIAGE SERVICES, INC., a Delaware corporation (the "Borrower"), the banks listed on the signature pages hereof (the "Lenders"), WELLS FARGO BANK, N.A., as Syndication Agent (in said capacity, the "Syndication Agent"), and BANK OF AMERICA, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer (in said capacity as Administrative Agent, the "Administrative Agent").

BACKGROUND

A. The Borrower, the Lenders, the Syndication Agent, and the Administrative Agent are parties to that certain Credit Agreement, dated as of April 27, 2005 (the "Credit Agreement"; the terms defined in the Credit Agreement and not otherwise defined herein shall be used herein as defined in the Credit Agreement).

B. The Borrower has requested that the Lenders amend the Credit Agreement, as more fully set forth herein.

C. The Lenders parties to this First Amendment (which Lenders constitute the Required Lenders as required under the Credit Agreement) are willing to agree to such amendment, subject to the performance and observance in full of each of the covenants, terms and conditions, and in reliance upon all of the representations and warranties of the Borrower, set forth herein.

NOW, THEREFORE, in consideration of the covenants, conditions and agreements hereafter set forth, and for other good and valuable consideration, the receipt and adequacy of which are all hereby acknowledged, the parties hereto covenant and agree as follows:

1. AMENDMENTS.

(a) The definition of "Applicable Rate" set forth in Section 1.01 of the Credit Agreement is hereby amended to read as follows:

> "Applicable Rate" means the following percentages per annum, based upon the Leverage Ratio as set forth in the most recent Compliance Certificate received by the Administrative Agent pursuant to Section 6.02(a):

Applicable Rate

Pricing Level	Leverage Ratio	Commitment Fee	Eurodollar Rate + Letters of Credit	Base Rate +
1	Less than 2.75 to 1.00	0.500	2.000	0.500
2	Less than 3.25 to 1.00 but equal to or greater than 2.75 to 1.00	0.500	2.500	1.000
3	Less than 3.75 to 1.00 but equal to or greater than 3.25 to 1.00	0.500	2.750	1.250
4	Greater than or equal to 3.75 to 1.00	0.750	3.000	1.500

Any increase or decrease in the Applicable Rate resulting from a change in the Leverage Ratio shall become effective as of the first Business Day immediately following the date a Compliance Certificate is delivered pursuant to Section 6.02(a); provided, however, that if a Compliance Certificate is not delivered when due in accordance with such Section, then Pricing Level 4 shall apply as of the first Business Day after the date on which such Compliance Certificate was required to have been delivered and shall remain in effect until the first Business Day immediately following the date such Compliance Certificate is actually delivered to the Administrative Agent. Notwithstanding the foregoing, the Applicable Rate in effect from August 31, 2005 through and including the date the first Compliance Certificate is delivered pursuant to Section 6.02(a) after August 31, 2005 shall be determined based upon Pricing Level 4.

(b) The definition of "Total Senior Debt" set forth in Section 1.01 of the Credit Agreement is hereby amended to read as follows:

"Total Senior Debt" means, at any time, an amount equal to the remainder of (a) Debt of the Borrower and its Subsidiaries minus (b) all Subordinated Debt of the Borrower and its Subsidiaries (including the Trust Notes).

(c) Section 7.11(a) of the Credit Agreement is hereby amended to read as follows:

(a) Maximum Leverage Ratio. Permit the Leverage Ratio at any time during any period of four fiscal quarters of the Borrower set forth below in which the last fiscal quarter ends after the Closing Date to be greater than the ratio set forth below opposite such period:

Four Fiscal Quarters Ending	Maximum Leverage Ratio
September 30, 2005 through December 31, 2005	4.50 to 1.00
March 31, 2006 through September 30, 2006	4.25 to 1.00
December 31, 2006 through December 31, 2007	4.00 to 1.00
March 31, 2008 and each fiscal quarter thereafter	3.75 to 1.00

(d) Section 7.11(b) of the Credit Agreement is hereby amended to read as follows:

(b) Minimum Fixed Charge Coverage Ratio. Permit as of the end of any period of four consecutive fiscal quarters in which the last fiscal quarter ends on or after September 30, 2005 to be less than 1.25 to 1.00.

(e) Exhibit B to the Credit Agreement is hereby amended to be in the form of Exhibit B to this First Amendment.

2. REPRESENTATIONS AND WARRANTIES TRUE; NO EVENT OF DEFAULT. By its execution and delivery hereof, the Borrower represents and warrants that, as of the date hereof:

(a) the representations and warranties contained in the Credit Agreement and the other Loan Documents are true and correct on and as of the date hereof as made on and as of such date;

(b) no event has occurred and is continuing which constitutes a Default or Event of Default;

(c) (i) the Borrower has full power and authority to execute and deliver this First Amendment, (ii) this First Amendment has been duly executed and delivered by the Borrower, and (iii) this First Amendment constitutes the legal, valid and binding obligations of the Borrower, enforceable in accordance with its terms, except as enforceability may be limited by applicable debtor relief laws and by general principles of equity (regardless of whether enforcement is sought in a proceeding in equity or at law) and except as rights to indemnity may be limited by federal or state securities laws;

(d) neither the execution, delivery and performance of this First Amendment, nor the consummation of any transactions contemplated herein or therein, will conflict with (i) the certificate or articles of incorporation or the applicable constituent documents or bylaws of the Borrower or its Subsidiaries, (ii) to Borrower’s knowledge, any provision or law, statute, rule or regulation applicable to the Borrower or its Subsidiaries or (iii) any indenture, agreement or other instrument to which the Borrower, the Subsidiaries or any of their properties are subject; and

(e) no authorization, approval, consent, or other action by, notice to, or filing with, any governmental authority or other Person not previously obtained is required for (i) the execution, delivery or performance by the Borrower of this First Amendment or (ii) the acknowledgement by each Guarantor of this First Amendment.

3. CONDITIONS OF EFFECTIVENESS. This First Amendment shall be effective on and as August 31, 2005, subject to the following:

(a) the representations and warranties set forth in Section 2 of this First Amendment shall be true and correct;

(b) the Administrative Agent shall have received counterparts of this First Amendment executed by the Required Lenders; and

(c) the Administrative Agent shall have received counterparts of this First Amendment executed by the Borrower and acknowledged by each Guarantor.

4. GUARANTOR'S ACKNOWLEDGMENT. By signing below, each Guarantor (i) acknowledges, consents and agrees to the execution, delivery and performance by the Borrower of this First Amendment, (ii) acknowledges and agrees that its obligations in respect of its Guaranty are not released, diminished, waived, modified, impaired or affected in any manner by this First Amendment, or any of the provisions contemplated herein, (iii) ratifies and confirms its obligations under its Guaranty and (iv) acknowledges and agrees that it has no claim or offsets against, or defenses or counterclaims to, its Guaranty.

5. REFERENCE TO THE CREDIT AGREEMENT.

(a) Upon and during the effectiveness of this First Amendment, each reference in the Credit Agreement to "this Agreement", "hereunder", or words of like import shall mean and be a reference to the Credit Agreement, as affected and amended by this First Amendment.

(b) Except as expressly set forth herein, this First Amendment shall not by implication or otherwise limit, impair, constitute a waiver of, or otherwise affect the rights or remedies of the Administrative Agent or the Lenders under the Credit Agreement or any of the other Loan Documents, and shall not alter, modify, amend, or in any way affect the terms, conditions, obligations, covenants, or agreements contained in the Credit Agreement or the other Loan Documents, all of which are hereby ratified and affirmed in all respects and shall continue in full force and effect.

6. COSTS AND EXPENSES. The Borrower shall be obligated to pay the costs and expenses of the Administrative Agent in connection with the preparation, reproduction, execution and delivery of this First Amendment and the other instruments and documents to be delivered hereunder.

7. EXECUTION IN COUNTERPARTS. This First Amendment may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which when taken together shall constitute but one and the same instrument. For purposes of this First Amendment, a counterpart hereof (or signature page thereto) signed and transmitted by any Person party hereto to the Administrative Agent (or its counsel) by facsimile machine, telecopier or electronic mail is to be treated as an original. The signature of such Person thereon, for purposes hereof, is to be considered as an original signature, and the counterpart (or signature page thereto) so transmitted is to be considered to have the same binding effect as an original signature on an original document.

8. GOVERNING LAW; BINDING EFFECT. This First Amendment shall be governed by and construed in accordance with the laws of the State of Texas applicable to agreements made and to be performed entirely within such state; provided that the Administrative Agent and each Lender shall retain all rights arising under federal law. This First Amendment shall be binding upon the Borrower and each Lender and their respective successors and assigns.

9. HEADINGS. Section headings in this First Amendment are included herein for convenience of reference only and shall not constitute a part of this First Amendment for any other purpose.

10. **ENTIRE AGREEMENT. THE CREDIT AGREEMENT, AS AMENDED BY THIS FIRST AMENDMENT, AND THE OTHER LOAN DOCUMENTS REPRESENT THE FINAL AGREEMENT BETWEEN THE PARTIES AS TO THE SUBJECT MATTER THEREIN AND HEREIN AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS BETWEEN THE PARTIES.**

REMAINDER OF PAGE LEFT INTENTIONALLY BLANK

IN WITNESS WHEREOF, the parties hereto have executed this First Amendment as of the date above written.

CARRIAGE SERVICES, INC.

By: /s/ Joseph Saporito

Joseph Saporito
Executive Vice President and Chief Financial Officer

BANK OF AMERICA, N.A., as
Administrative Agent

By: /s/ Suzanne M. Paul
Name: Suzanne M. Paul
Title: Vice President

BANK OF AMERICA, N.A., as a Lender, L/C Issuer and Swing Line Lender

By: /s/ Gary L. Mingle
Name: Gary L. Mingle
Title: Senior Vice President

WELLS FARGO BANK, NATIONAL ASSOCIATION, as Syndication Agent and as a Lender

By: /s/ Warren R. Ross

Name: Warren R. Ross

Title: Vice President

GUARANTORS:

CARRIAGE FUNERAL HOLDINGS, INC.
CFS FUNERAL SERVICES, INC.
CARRIAGE HOLDING COMPANY, INC.
CARRIAGE FUNERAL SERVICES OF MICHIGAN, INC.
CARRIAGE FUNERAL SERVICES OF KENTUCKY, INC.
CARRIAGE FUNERAL SERVICES OF CALIFORNIA, INC.
CARRIAGE CEMETERY SERVICES OF IDAHO, INC.
WILSON & KRATZER MORTUARIES
ROLLING HILLS MEMORIAL PARK
CARRIAGE SERVICES OF CONNECTICUT, INC.
CSI FUNERAL SERVICES OF MASSACHUSETTS, INC.
CHC INSURANCE AGENCY OF OHIO, INC.
BARNETT, DEMROW & ERNST, INC.
CARRIAGE SERVICES OF NEW MEXICO, INC.
FORASTIERE FAMILY FUNERAL SERVICE, INC.
CARRIAGE CEMETERY SERVICES, INC.
CARRIAGE SERVICES OF OKLAHOMA, L.L.C.
CARRIAGE SERVICES OF NEVADA, INC.
HUBBARD FUNERAL HOME, INC.
CARRIAGE TEAM CALIFORNIA (CEMETERY), LLC
CARRIAGE TEAM CALIFORNIA (FUNERAL), LLC
CARRIAGE TEAM FLORIDA (CEMETERY), LLC
CARRIAGE TEAM FLORIDA (FUNERAL), LLC
CARRIAGE SERVICES OF OHIO, LLC
CARRIAGE TEAM KANSAS, LLC
CARRIAGE MUNICIPAL CEMETERY SERVICES OF NEVADA, INC.
CARRIAGE CEMETERY SERVICES OF CALIFORNIA, INC.
CARRIAGE INTERNET STRATEGIES, INC.
CARRIAGE INVESTMENTS, INC.
CARRIAGE MANAGEMENT, L.P.
HORIZON CREMATION SOCIETY, INC.
CARRIAGE LIFE EVENTS, INC.
CARRIAGE MERGER I, INC.
CARRIAGE MERGER II, INC.
CARRIAGE MERGER III, INC.
CARRIAGE MERGER IV, INC.
CARRIAGE INSURANCE AGENCY OF MASSACHUSETTS, INC.

By: /s/ Joseph Saporito
Joseph Saporito, Executive Vice President and
Chief Financial Officer

COCHRANE'S CHAPEL OF THE ROSES, INC.

By: /s/ Doug Wagemann
Doug Wagemann
Secretary

EXHIBIT B

FORM OF COMPLIANCE CERTIFICATE

Financial Statement Date: __________, __________

To: Bank of America, N.A., as Administrative Agent

Ladies and Gentlemen:

Reference is made to that certain Credit Agreement, dated as of April 27, 2005 (as amended, restated, extended, supplemented or otherwise modified in writing from time to time, the "Agreement;" the terms defined therein being used herein as therein defined), among Carriage Services, Inc., a Delaware corporation (the "Borrower"), the Lenders from time to time party thereto, and Bank of America, N.A., as Administrative Agent, L/C Issuer and Swing Line Lender.

The undersigned Responsible Officer hereby certifies as of the date hereof that he/she is the ____ of the Borrower, and that, as such, he/she is authorized to execute and deliver this Certificate to the Administrative Agent on the behalf of the Borrower, and that:

*[Use following paragraph 1 for fiscal **year-end** financial statements]*

1. Attached hereto as Schedule 1 are the year-end audited financial statements required by Section 6.01(a) of the Agreement for the fiscal year of the Borrower ended as of the above date, together with the report and opinion of an independent certified public accountant required by such section.

*[Use following paragraph 1 for fiscal **quarter-end** financial statements]*

1. Attached hereto as Schedule 1 are the unaudited financial statements required by Section 6.01(b) of the Agreement for the fiscal quarter of the Borrower ended as of the above date. Such financial statements fairly present the financial condition, results of operations and cash flows of the Borrower and its Subsidiaries in accordance with GAAP as at such date and for such period, subject only to normal year-end audit adjustments and the absence of footnotes.

2. The undersigned has reviewed and is familiar with the terms of the Agreement and has made, or has caused to be made under his/her supervision, a detailed review of the transactions and condition (financial or otherwise) of the Borrower during the accounting period covered by the attached financial statements.

3. A review of the activities of the Borrower during such fiscal period has been made under the supervision of the undersigned with a view to determining whether during such fiscal period the Borrower performed and observed all its Obligations under the Loan Documents, and

[select one:]

[to the best knowledge of the undersigned during such fiscal period, the Borrower performed and observed each covenant and condition of the Loan Documents applicable to it.]

—or—

[the following covenants or conditions have not been performed or observed and the following is a list of each such Default and its nature and status:]

4. The representations and warranties of the Borrower contained in Article V of the Agreement, or which are contained in any document furnished at any time under or in connection with the Loan Documents, are true and correct on and as of the date hereof, except to the extent that such representations and warranties specifically refer to an earlier date, in which case they are true and correct as of such earlier date, and except that for purposes of this Compliance Certificate, the representations and warranties contained in subsections (a) and (b) of Section 5.05 of the Agreement shall be deemed to refer to the most recent statements furnished pursuant to clauses (a) and (b), respectively, of Section 6.01 of the Agreement, including the statements in connection with which this Compliance Certificate is delivered.

5. The financial covenant analyses and information set forth on Schedule 2 attached hereto are true and accurate on and as of the date of this Certificate.

IN WITNESS WHEREOF, the undersigned has executed this Certificate on behalf of the Borrower as of ____________________, __________ .

CARRIAGE SERVICES, INC.

By: ____

Name:

Title

For the Quarter/Year ended ____________________(“Statement Date”)

SCHEDULE 2
to the Compliance Certificate
($ in 000’s)

I. Section 7.11 (a) — Maximum Leverage Ratio.

A. Total Senior Debt at Statement Date:

(1) Debt of the Borrower and its Subsidiaries at Statement Date:	$	____
(2) Subordinated Debt of the Borrower and its Subsidiaries at Statement Date:	$	____
(3) Total Senior Debt (Lines I.A.1 - 2):	$	____

B. EBITDA for four consecutive fiscal quarters ending on the Statement Date (“Subject Period”):

(1) Net Income for the Subject Period:	$	____
(2) To the extent deducted in calculating Net Income, Interest Expense for the Subject Period:	$	____
(3) To the extent deducted in calculating Net Income, the provision for federal, state, local and foreign income taxes payable by the Borrower and its Subsidiaries for the Subject Period:	$	____
(4) To the extent deducted in calculating Net Income, depreciation and amortization expenses and payments in respect of Deferred Purchase Price for the Subject Period:	$	____
(5) To the extent deducted in calculating Net Income, other expenses of the Borrower and the Subsidiaries reducing Net Income which do not represent a cash item in the Subject Period or any future period:	$	____
(6) Non-cash items increasing Net Income for the Subject Period:	$	____
(7) EBITDA (Lines I.B.1 + 2 + 3 + 4 + 5 - 6):	$	____

C. Leverage Ratio (Line I.A. ¸ Line I.B.7): _____ to ______

Maximum permitted:

Four Fiscal Quarters Ending	Maximum Leverage Ratio
September 30, 2005 through December 31, 2005	4.50 to 1.00
March 31, 2006 through September 30, 2006	4.25 to 1.00
December 31, 2006 through December 31, 3007	4.00 to 1.00
March 31, 2008 and each fiscal quarter thereafter	3.75 to 1.00

II. Section 7.11(b) — Minimum Fixed Charge Coverage Ratio.

A.	EBITDA for the Subject Period (Line I.B.7. above):	$	____
B.	Capital Expenditures for the Subject Period:	$	____
C.	Cash taxes paid during the Subject Period:	$	____
D.	Cash tax refunds received during the Subject Period:	$	____
E.	Cash Interest Expense during the Subject Period (excluding (x) the Make-Whole Premium paid to the holders of the Old Senior Notes that were retired in January 2005 and (y) the amount of Trust Preferred Interest Deferral paid in March 2005 in respect of interest deferred from September 2003 through December 2004):	$	____
F.	Scheduled and required principal payments during the Subject Period in respect of Debt (other than scheduled and required principal payments on the Old Senior Notes):	$	____
G.	Scheduled and required payments made by the Borrower in respect of Deferred Purchase Price for the Subject Period (to extent not included in II.E. and II.F. above):	$	____
H.	Fixed Charge Coverage Ratio (Lines II.A. — II.B. — II.C. + II.D.) ¸ (Lines II.E. + II.F. + II.G):		______ to 1

Minimum required:

Four Fiscal Quarters Ending	Minimum Fixed Charge Coverage Ratio
September 30, 2005 and each fiscal quarter thereafter	1.25 to 1.00

EXHIBIT 11.1

CARRIAGE SERVICES, INC.
COMPUTATION OF PER SHARE EARNINGS
(unaudited and in thousands, except per share data)

Earnings per share for the three and nine month periods ended September 30, 2004 and 2005 is calculated based on the weighted average number of common and common equivalent shares outstanding during the periods as prescribed by SFAS 128. The following table sets forth the computation of the basic and diluted earnings per share for the three and nine month periods ended September 30, 2004 and 2005:

	Three months ended September 31,		Nine months ended September 30,	
	2004	2005	2004	2005
Income (loss) from continuing operations available to common stockholders	$ 471	$ 140	$ 5,089	$ (782)
Income (loss) from discontinued operations available to common stockholders	686	530	(1,338)	881
Change in accounting method	—	—	—	(22,756)
Effect of dilutive securities	—	—	—	—
Net income (loss) available to common stockholders	$ 1,157	$ 670	$ 3,751	$ (22,657)
Weighted average number of common shares outstanding for basic EPS computation	17,834	18,426	17,751	18,294
Effect of dilutive securities:				
Stock options	447	512	475	—
Weighted average number of common and common equivalent shares outstanding for diluted EPS computation	18,281	18,938	18,226	18,294
Basic earnings (loss) per common share:				
Continuing operations	$ 0.03	$ 0.01	$ 0.29	$ (0.04)
Discontinued operations	$ 0.04	$ 0.03	$ (0.08)	$ 0.05
Cumulative effect of change in accounting method	$ —	$ —	$ —	$ (1.25)
Net income (loss)	$ 0.07	$ 0.04	$ 0.21	$ (1.24)
Diluted earnings (loss) per common share:				
Continuing operations	$ 0.03	$ 0.01	$ 0.28	$ (0.04)
Discontinued operations	$ 0.03	$ 0.03	$ (0.07)	$ 0.05
Cumulative effect of change in accounting method	$ —	$ —	$ —	$ (1.25)
Net income (loss)	$ 0.06	$ 0.04	$ 0.21	$ (1.24)

Options to purchase $0.1 million and $1.5 million shares were not included in the computation of diluted earnings per share for the three and nine month periods, respectively ending September 30, 2005, because the effect would be antidilutive. Options to purchase 0.2 million shares were not included in the computation of diluted earnings per share for the periods ending September 30, 2004, because the effect would be antidilutive.

The convertible junior subordinated debenture is convertible into 4.6 million shares of common stock and is not included in the computation of diluted earnings per share because the effect would be antidilutive.

EXHIBIT 31.1

I, Melvin C. Payne, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Carriage Services, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:

   a. designed such disclosure controls and procedures, or caused such controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is prepared;

   b. evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c. disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):

   a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal controls over financial reporting.

Dated: November 11, 2005

/s/ Melvin C. Payne
Melvin C. Payne
Chairman of the Board, President and Chief Executive Officer

EXHIBIT 31.2

I, Joseph Saporito, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Carriage Services, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
    a. designed such disclosure controls and procedures, or caused such controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is prepared;
    b. evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    c. disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):
    a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
    b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal controls over financial reporting.

Dated: November 11, 2005

/s/ Joseph Saporito
Joseph Saporito
Executive Vice President and Chief Financial Officer

EXHIBIT 32.1

I, Melvin C. Payne, certify pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that: (i) the attached Quarterly Report on Form 10-Q of Carriage Services, Inc. for the period September 30, 2005 (“Form 10-Q”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and (ii) the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Carriage Services, Inc.

November 11, 2005

/s/ Melvin C. Payne

Melvin C. Payne
Chairman of the Board, President and Chief Executive Officer

EXHIBIT 32.2

I, Joseph Saporito, certify pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that: (i) the attached Quarterly Report on Form 10-Q of Carriage Services, Inc. for the period September 30, 2005 ("Form 10-Q") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and (ii) the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Carriage Services, Inc.

November 11, 2005

/s/ Joseph Saporito

Joseph Saporito
Executive Vice President and Chief Financial Officer